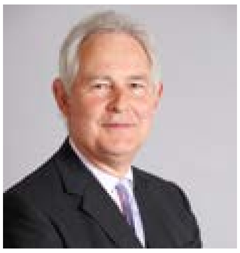
Performance

UKEF's non-executive chair leads the UKEF Board as it advises the Accounting Officer on all matters of material importance to the department, such as business and operational planning, business performance, financial risk management and compliance with risk policies.

Chairman's report Guy Beringer CBE



I was pleased to welcome Louis Taylor to the board in October as the new UKEF Chief Executive. His predecessor, David Godfrey, left the department after 2 years' service as Chief Executive, and having previously been a non-executive director. David oversaw many developments in the department during his tenure as Chief Executive, and the board thanks him for his time and leadership in the role and for the sound footing on which he left the department.

This year also saw the retirement of the Business Group Director, Steve Dodgson. Steve was an Executive Committee member and board member, and served the department in various roles for 42 years. The board would also like to thank him for his considerable contribution to the success of the organisation.

There has been a renewed appetite from the commercial markets to get involved in export finance, so we have not been called upon for support at levels recently experienced, especially in the aerospace sector. This is not unique to UKEF but also applies to other export credit agencies across the world, as they look to support their respective industrial base. We continue, however, to find new ways in which we can give support to UK exporters and their customers, and we are reaching greater numbers of exporters, particularly SMEs, as we seek to broaden our reach to all sizes of business.

The UKEF business plan sets out the main elements of the strategic direction for the department. One of the priorities is that we will have a competitive offering. The department seeks to ensure that it is one of the most competitive export credit agencies in the global marketplace by providing a full range of financing tools and making sure that there is a level playing field for UK exporters faced with competition supported by comparable export credit agencies.

Our other strategic priorities are to improve customer delivery and awareness, be agile and adaptable, and ensure that the organisation is a great place to work for the staff.

I am pleased, therefore, that feedback on UKEF's performance from trade bodies such as the British Exporters Association, and the trade press such as Global Trade Review and TXF: Trade & Export Finance, remains very encouraging. The broadening of UKEF's legal powers and a fully operational direct lending product are both significant developments in the department adapting to new market requirements. Along with this, UKEF's already broad product range, strong guarantee and flexible foreign content rules are all advantages for supporting exporters across the UK.

These innovations already implemented and new measures being piloted to streamline trade finance products will help to ensure that we remain one of the most competitive and responsive export credit agencies anywhere in the world.

Guy Beringer CBE
Chairman
23 June 2016

Our mission is to ensure no viable UK export fails for want of finance or insurance, while operating at no net cost to the taxpayer.

Chief Executive's report Louis Taylor

We made significant progress towards our mission in the year, increasing the number of exporters who benefited from our support and continuing our work to develop and enhance the range of solutions we offer to UK companies.

I joined UKEF in October 2015, taking over from David Godfrey, whom I would like to thank for the good shape of the department, and in particular for formulating such a comprehensive and apposite strategy for UKEF. This foundation contributed to our progress in the year.

The volume of business that UKEF supports year-on-year is a measure of private sector liquidity and risk appetite, as much as of our activity and success. We do not compete to grow our market share – rather, we help exporters grow theirs. We complement, rather than compete with, the financial and insurance support provided from the private sector. If support is available from a commercial bank or insurer, we do not seek to displace this. Where required, we will work with companies and banks to ensure that commercial support is found (which we report as a 'private market assist').

Our interventions:

- can fill market gaps
- provide additional export value for the UK economy
- support growth in overseas markets for the individual companies that benefit.

Our support is not aid:

- we charge a premium[1] to reflect the risk we assume
- commercial rates of interest are charged on lending
- the premium we charge must cover our long-term losses, as well as our long-term operating costs
- we aim to operate at no net cost to the taxpayer over business cycles
- we do not seek to make a profit

We have reviewed our performance against each of our 4 strategic aims within our 2014 to 2017 business plan:

Agile and adaptable: to be an agile department, able to address the challenges to UK exporters throughout the economic cycle.

Competitive offering: to be active in ensuring that we are one of the most competitive export credit agencies in the global marketplace.

Customer delivery and awareness: to provide a quality of service to our customers that is proactive, flexible and efficient with a focus on solutions and innovation.

Our organisation: to be a great place to work where teams work across functions easily, and to common goals.

1 When we use the term 'Premium' this should be taken to include guarantee fees or other fees.

In 2015-16 we have continued to:

grow by 23% the number of businesses that directly benefit from our support – you can read some of their stories on pages 49 to 63

develop our support so we can bridge more gaps in market provision, and can anticipate and respond quickly to changing demands

support UK companies bidding for and winning high-value opportunities by supporting competitive finance packages and lines of credit to overseas buyers

encourage innovation and a positive customer experience, by continually examining what we do and making improvements to ensure that our support continues to match or exceed the support provided by other export credit agencies

protect the taxpayer from loss, through the application and development of robust risk and portfolio management methods

raise awareness of the support we can provide among UK companies and intermediaries so those that need our support know it is there and can access it

increase the learning and development provided to our staff

cooperate across government, for example:

- as part of the Exporting is GREAT campaign
- with UK Trade & Investment (UKTI) on how best to support overseas marketing for UK companies
- with the British Business Bank, to review the finance challenges facing small and medium-sized enterprises (SMEs) that export or are looking to export, to ensure that government support best addresses their needs

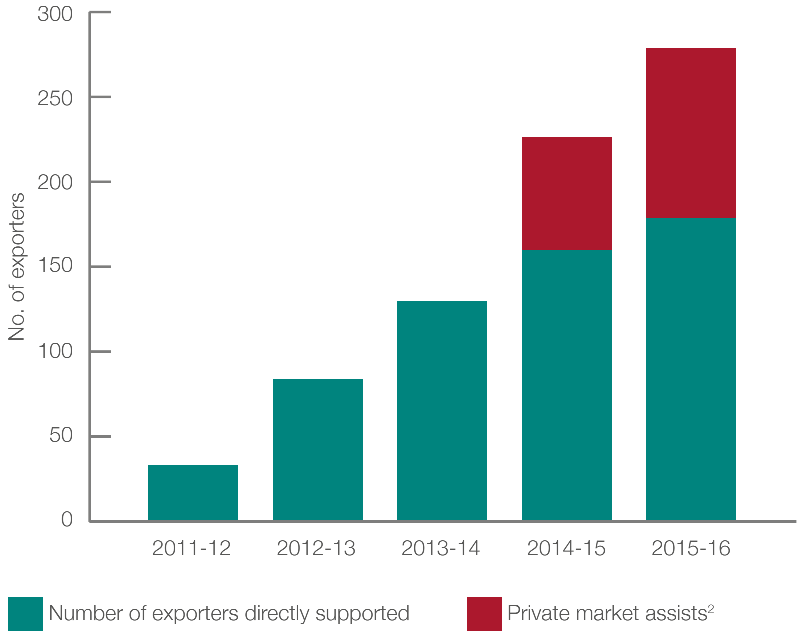
UKEF's strategic aims:

- Agile and adaptable
- Competitive offering
- Customer Service and awareness
- Great place to work

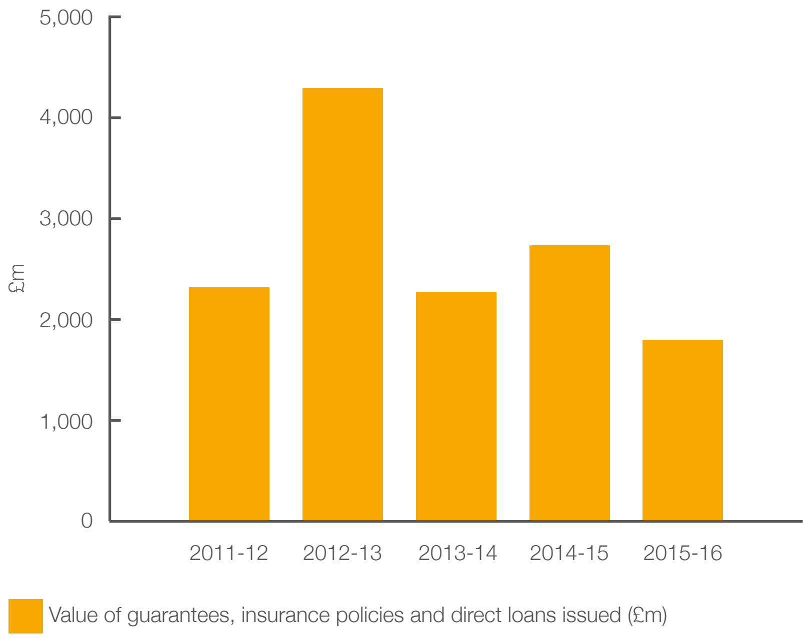
Businesses supported

We supported 279 companies in 2015-16. The maximum liability on all new business was £1.8 billion. Our trade finance products supported £818 million of export contracts won by UK businesses.

Number of exporters supported

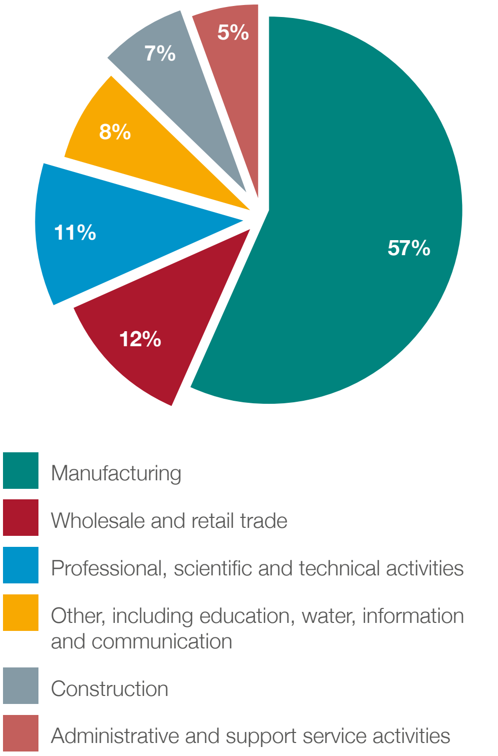


Value of business issued

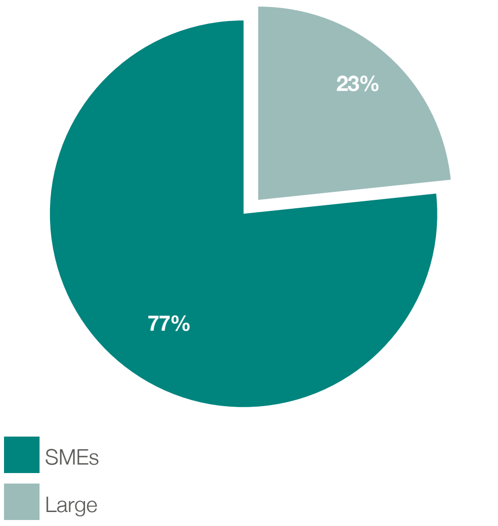


2 A 'private market assist' is when our engagement has had a material contribution to a company receiving support from the private sector, resulting in an export contract going ahead that was unlikely to have proceeded otherwise.

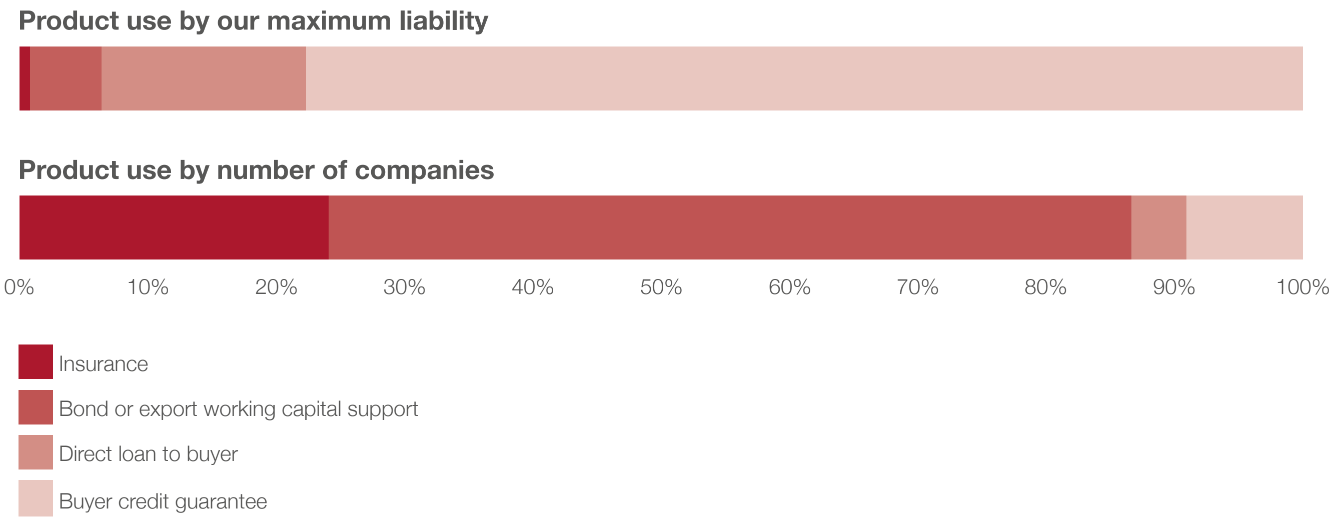
Sectors



Company size



Destinations for exports supported in 2015-16: darker shading indicates higher value of UKEF support.



> "Exporting can help businesses grow – and grow fast. The statistics show that in the first two years of exporting alone, a business can grow by up to one-third. That means more jobs, more profits, more tax revenue and more benefit to society."

Lord Price, Minister for Trade and Investment

Highlights in 2015-16

UKEF supported more than
£800 million
of new UK export contracts via our trade finance and insurance products and issued **£1,679 million** of export credit support

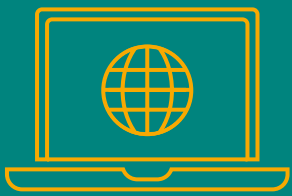
We reached an agreement with GE that was instrumental in the company committing to a significant investment in the UK, with the potential to create
more than 1,000 jobs

We exceeded **£3 billion** of export contracts supported through new products introduced in 2011 in response to the economic downturn

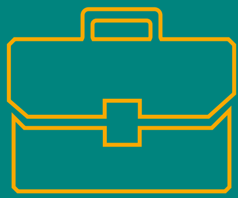
UKEF was the first export credit agency outside China to guarantee a
loan in chinese currency
(the offshore renminbi), paving the way for UK companies to export more easily to the Chinese market

Our export finance advisers held more than 2,500
one-to-one interactions
with UK companies and more than 1,500 with intermediaries this year

More than
7,000 companies
are likely to benefit from our support via large exporter supply chains



The department began development of a
new digital interface
to support customer applications that will be made available in 2016-17

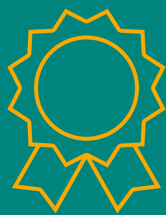


We reintroduced cover to support UK companies seeking to compete for
business in Iran

We completed a public consultation that allowed for
simplification
of our application process

We continued to be a
recognised leader
among OECD export credit agencies in the application of environmental, social and human rights due diligence

We developed detailed
online product guides
to help and encourage bank staff and insurance brokers to use them in support of their clients



We adopted the
equator principles
during the year, alongside our parallel commitment to meet OECD recommended standards

Finances

UKEF achieved an operating surplus for the year ended 31 March 2016 of £106 million compared with £129 million for the year to 31 March 2015. The decrease in net operating income for the year was largely the result of:

- a decrease in the release from the underwriting funds closed in the current year to £36 million in 2015-16 from £52 million in 2014-15
- a lower foreign exchange gain of £13 million for 2015-16 compared with a gain of £34 million in 2014-15

We met all our financial objectives, which are set for us by HM Treasury.

Page 34 sets out our results against our financial objectives and page 93 contains a comprehensive report of our financial performance.

Image UKEF are heavily involved in the whole-of-government's Exporting is GREAT campaign, which is promoting live export opportunities for UK companies and highlighting the support available.

How we protect the taxpayer

We price risk by performing a balancing act to enable us to operate at no net cost to the taxpayer over time.

Our aim is to break even over time. To help make sure that we do, every month we calculate the premium we earn and weigh it up against an estimate of all the potential costs and losses for the business supported.

We measure this over different 3-year periods. The diagram below shows the result based on actuals for 2013 to 2016.

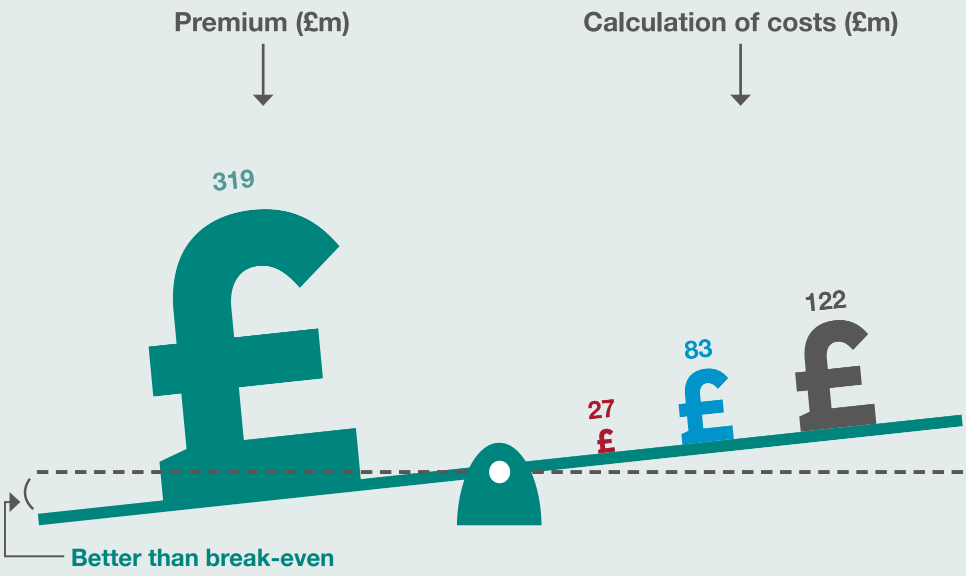
The costs have 3 components:

£ – a statistical estimate of potential losses that cannot be recovered

£ – administration costs

£ – a further amount to allow for a portion of unexpected losses

2013 to 2016



This measure, called a pricing adequacy index, provides assurance that our pricing is sufficient to meet all potential costs for the business supported.

Note The premium amount for 2013-16 applied to our pricing adequacy index differs from the accounted premium reported on page 33. This is because the accounted premium:

- does not include premium from direct lending, which is amortised as interest income
- uses an exchange rate fixed at the time premium is received (rather than month-end rates)
- includes only the premium earned in the period (rather than the entire premium expected over the life of the business issued)

Supporting exports through the business cycle

Many of the loans we support will be repaid over more than 10 years and, in the event of defaults, we will seek to make recoveries. This means that final business losses, as a result of unrecovered claims paid, can take many years to crystallise.

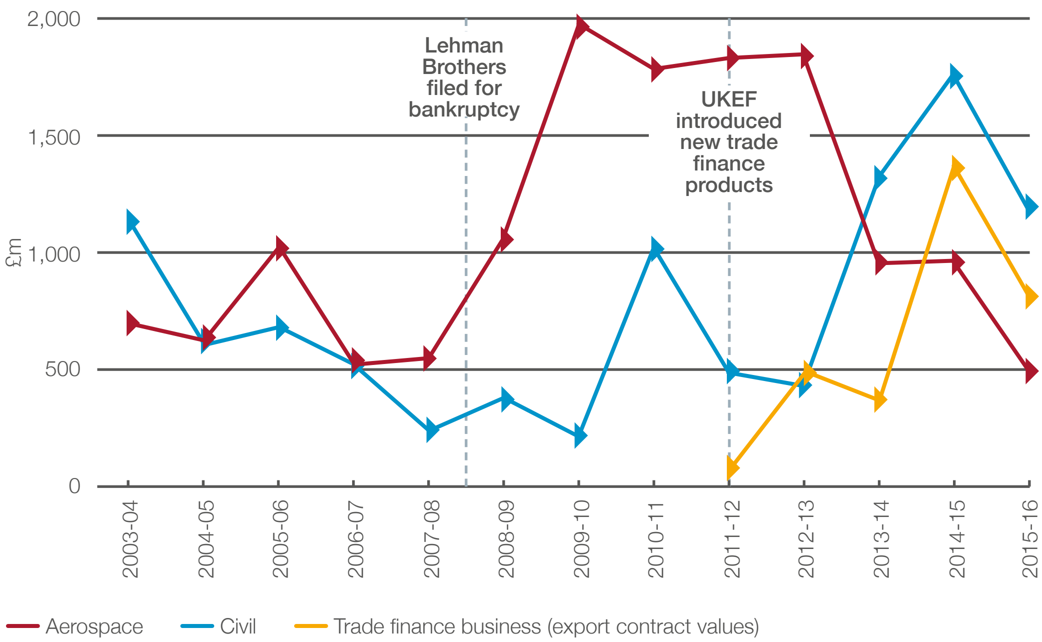
To some extent our role is best appreciated 'through the business cycle' as our business levels (and claims) rise and fall depending on the impact of market disruptions on UK trade.

The financial crisis that started in 2007 demonstrated UKEF's 'counter-cyclical' role.

The graph below illustrates that:

- UKEF support for aircraft exports peaked in 2010 to 2012 as UKEF helped sustain planned deliveries
- civil project business took more time to be reflected in UKEF support due to projects taking longer to come to fruition

UKEF had to rebuild its support for short-term business, as this had been privatised in 1991 – this rebuilding will help us provide an agile and swift response in the event of future market disruption.



Note Aerospace and civil business support are represented above by UKEF's maximum liability at time of support. In contrast, the value of trade finance business is represented by the total export contract value. This has been done to help represent the impact of UKEF's different areas of support on UK business through the cycle. Large defence business has been excluded.

Performance assessment

Assessing our performance should take into account:

- the overall volume of our support (as reported on page 33)
- our ability to provide this support while covering our operating costs and losses
- our potential market share, ie the size of the 'market gap' we need to bridge

Bridging the gap

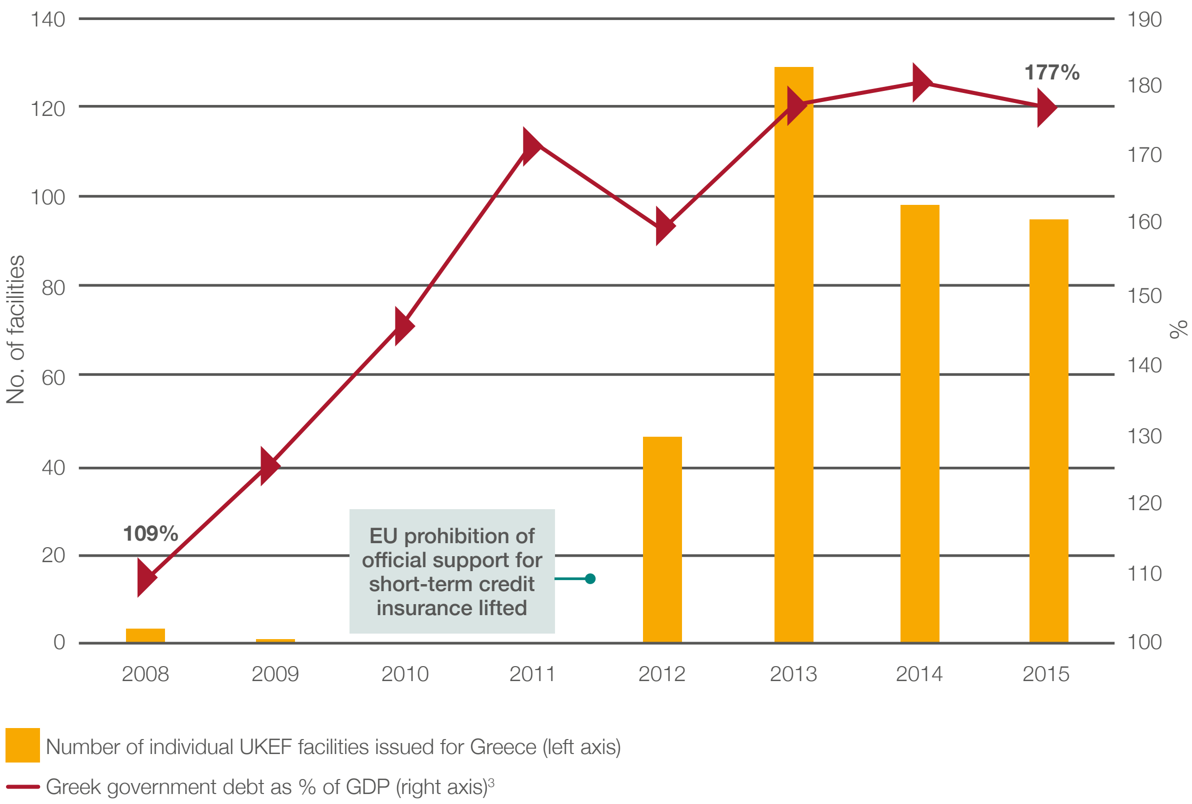
Our potential market share is partially determined by **external factors** over which UKEF has no control:

- the economic environment and the demand for finance and insurance to support UK exports
- the ability of commercial credit insurers and finance providers to meet this demand

It is also partially determined by factors over which UKEF has a degree of control:

- **awareness** among exporters of UKEF's ability to help and the willingness of our commercial partners (eg banks and brokers) to use and promote our services
- our **pricing of risk**, reflected in the premium and/or interest we charge
- whether we have the **product range** required to fill the particular market gaps

How UKEF fills market gaps: the Greek example



3 Source: Eurostat

External factors

Overall, external factors in 2015-16 are most likely to have reduced the inherent demand for our support.

The net effect of external factors during the year appeared to be a global fall in demand for all export credit agency support. These factors included a slowdown in global growth, a historically low oil price, generally high levels of bank liquidity, a strongly recovering commercial credit insurance market and a slight increase in bank lending.

Our Chief Economist's full commentary is on page 37.

Awareness

Considerable progress has been made in raising awareness of UKEF, but we have more work to do.

We track awareness levels annually. The most recent survey, carried out in June 2015, showed that awareness levels had risen significantly among companies that had experienced difficulty accessing financial support. This suggests that, when we are needed, many companies are finding us.

However, it showed that half of the companies within our target segment still remained unaware of our support. It also revealed that other intermediaries in government and within banks were not introducing companies to UKEF as we would like.

We continue to work to address this and we expect to see more progress when we repeat the survey of our awareness early in 2016-17. We now have the additional opportunity to raise awareness of our support through the government's Exporting is GREAT campaign, which has secured significant investment over at least 5 years until 2020.

There is a review our work with partners on page 65.

Pricing of risk

We support UK exporter competitiveness by setting the lowest premium rates permissible, subject to meeting our financial objectives and to aligning with our international obligations, most notably the minimum rates set out by the OECD.

Our pricing methodology is described in more detail on pages 78 to 80.

Product range

UKEF's broad product range, strong guarantee, flexible foreign content rules and innovative approach are all advantages for UK exporters.

Feedback from trade bodies such as the British Exporters Association (BExA), and the trade press such as *Global Trade Review* and *TXF: Trade & Export Finance*, recognises these strengths.

Our longstanding status as a ministerial government department continues to provide a firm foundation.

Comparing UKEF with other export credit agencies

We assess the strength of our support primarily through listening to our customers and comparing our capabilities against other leading export credit agencies from around the world.

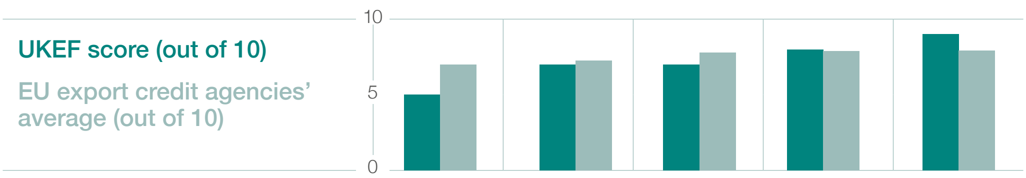
Every year the UKEF Board undertakes a comparison exercise to review our offering against that of other export credit agencies.

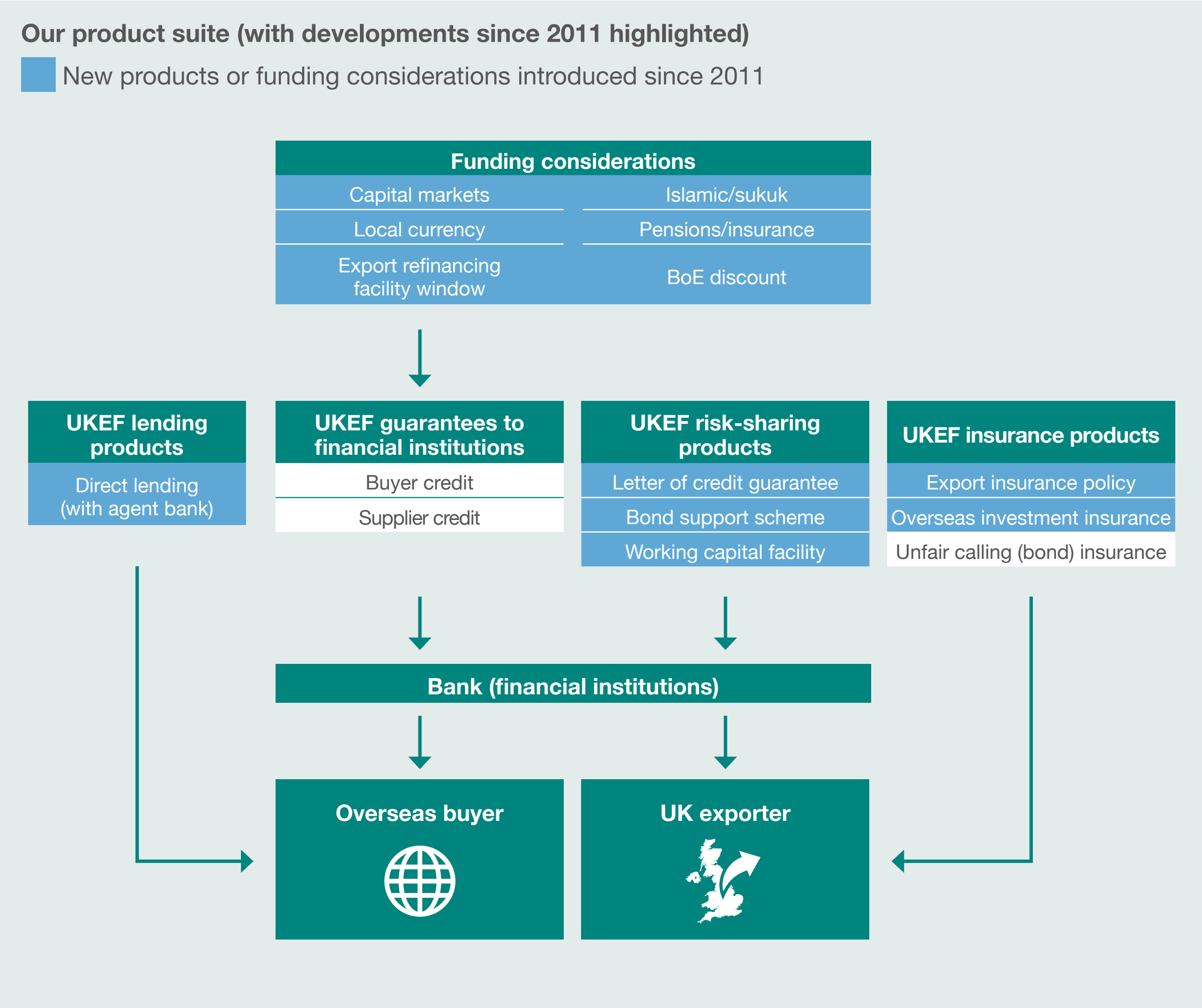
We also benefit from external scrutiny provided by the export credit agency benchmarking report produced each year by BExA, and research carried out by Clevis for TXF's Exporters' Choice Awards.

Our product range has evolved considerably since BExA's first benchmarking report in 2010, when we scored 4 out of 10, compared to 9 out of 10 today. We have now overtaken the average score for EU export credit agencies.

Results of annual benchmarking by the British Exporters' Association (BExA)

Products	2010-11	2011-12	2012-13	2013-14	2014 to present
Short-term insurance	●	✓	✓	✓	✓
Direct lending	●	●	●	✓	✓
Bond support scheme	●	✓	✓	✓	✓
Working capital facility	●	✓	✓	✓	✓
Export credit schemes	✓	✓	✓	✓	✓
Fixed rate financing (CIRR)	✓	●	●	●	✓
Investment insurance	✓	✓	✓	✓	✓
Unfair calling insurance	✓	✓	✓	✓	✓
Letter of credit guarantee	✓	✓	✓	✓	✓
Foreign exchange risk cover	●	●	●	●	●





Other performance factors

Enterprise risk

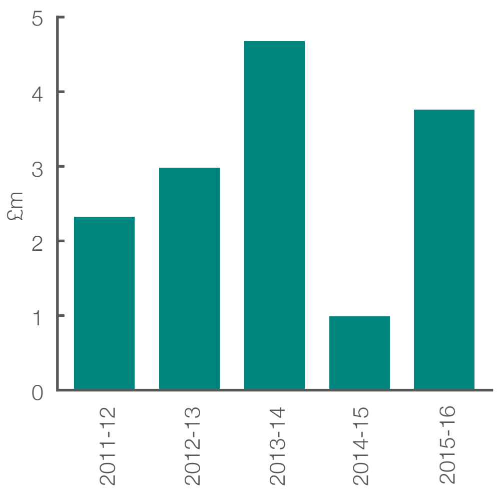
Managing risk is critical to our business. In addition to the management of credit risks, we face a variety of **other financial, operational and strategic risks** from external and internal sources.

As an export credit agency our credit risk portfolio will tend to be characterised by:

- a higher risk profile than commercial lenders or insurers
- a strong emerging market risk component
- long risk horizons
- material risk concentrations

In this context the low volume of new claims in each of the past 5 years, from a portfolio with more than £17.5 billion at risk, demonstrates a strong capability in credit risk decision-making.

Claims arising from new defaults (£m)



Taking the past 5 years, the average new claims as a proportion of the average amount at risk would be

0.015%

or £1 for every £6,864 at risk. We typically seek to recover claims we have paid, so any final loss calculation may not become clear for many years, until recovery action is concluded.

How we manage our **financial risks** is fully detailed on pages 69 to 91.

To manage **operational risk**, we are committed to establishing a continuous improvement culture across the organisation. The aim is to reduce operational losses arising from inadequate or failed internal processes, systems, external events, and contractual risk.

I am pleased to say there are no operational losses or special payments to report in 2015-16.

Our most significant **strategic risks** arise mainly from our need to:

- attract and retain the right people where salary levels may lag behind financial services and other public sector comparators
- develop, digitise and streamline our processes, and to get value for money from technology
- penetrate the market in terms of awareness
- compete with overseas competitors offering concessional lending or support outside OECD disciplines

There is a detailed description of the most significant of the **operational risks** facing our business and mitigating measures in the governance statement on pages 120 to 125.

Operational efficiency and effectiveness

We have embarked on a programme of investment in digital technology and services to improve the efficiency of our case process and customer relationship management, and to prepare for increased uptake of our products and services. This investment is the key element of our business transformation plan approved as part of our settlement under the 2015 Spending Review.

Read more about our operations and spending plans on page 67.

Working with partners

Our partnerships within government have gone from strength to strength. For example we work closely with UKTI, the government department responsible for co-ordinating whole-of-government efforts to support exports and for developing a coherent and joined-up service for UK companies. We provided expertise to UKTI on the development of potential export services, we are a part of the Exporting is GREAT campaign, and we will continue to join forces at every opportunity to help UK businesses trade internationally.

Our commercial partnerships have also developed, as we worked with partners to simplify our application processes, invited lenders to seek support for working capital facilities to companies supplying products or services to exporters and began a pilot of arrangements to reduce export finance application times through ending duplicated credit and other due diligence between lenders and UKEF.

The year ahead

We have 5 priorities for 2016-17:

- enhance our **performance** through a broader and deeper delivery of our mission
- become more **efficient** by continuously improving the way we work
- increase our **competence** by developing our talent and leadership capability
- improve **teamwork** by generously collaborating with partners
- grow our **brand** by building our reputation and stakeholder awareness

Banks and alternative finance providers

We plan to make it simpler for finance providers to share risks with us when providing credit facilities to companies that are involved with exporting, by giving them more control over the application process and widening the application of our support.

In 2016-17 we will:

- **complete a trial of arrangements to delegate more decision-making to finance providers, with the aim of cutting application times in half and accessing many more exporters who can benefit from our support**
- **provide training and toolkits to bank staff to support the use of our products under this new delivery model**

Customers

We plan to work more closely with UK prime contractors (whose large and complex contracts bring significant UK supply-chain benefits) to support competitive finance packages when they seek to win overseas contracts. We want to be helping companies win contracts, not just helping them fulfil contracts already won.

Smaller (SME) customers will benefit from our work with finance providers and brokers to streamline and broaden access to our support.

In 2016-17 we will:

- **trial an online application service that is simpler, clearer and faster than current arrangements**
- **develop a unified business development function that will raise awareness of our support and capabilities across the full spectrum of companies, from supply of exports through to end demand for exports of companies, and include all of UKEF's marketing efforts**

Government

The new Exporting is GREAT campaign demonstrates that a world of opportunity is out there for UK companies. The campaign is at the centre of a new whole-of-government approach to supporting exports. It also brings together commercial partners that share UKEF's interest in empowering more companies to export. We plan to exploit the potential of the Exporting is GREAT campaign and, with UKTI co-ordinating activity across government, we can do more to make sure that our support lands where it is needed.

In 2016-17 we will:

- **again test for increasing awareness of our support**
- **reach more companies via the Exporting is GREAT campaign**
- **continue to collaborate across government to help finance exports**

People

Our support is only as good as the people we employ to deliver it. We plan to make the most of our unique role spanning government and the financial services industry to attract talent and to make sure that our people reach their potential.

In 2016-17 we will:

- **implement changes to the structure of our business group under new leadership that allows for greater flexibility to marshal resource**
- **further increase learning and development opportunities for staff that will add to their ability to support exporters**
- **invest more heavily in developing current and future leadership talent for key roles**

As our capabilities and profile have grown, so has our ambition. We want to be the best export credit agency among our international peers, we want to be unafraid of going beyond our traditional role, and we want to be a high performing partner within UKTI-led programmes across government to support trade and investment.

Above all we want to realise our new mission statement to the fullest extent possible: to ensure no viable UK export fails for want of finance or insurance from the private sector, while operating at no net cost to the taxpayer.

Note on the result of the EU referendum

On 23 June the UK voted to leave the EU. The short-term impact of this on how UKEF continues to operate is unlikely to be material. We do not anticipate that it will require significant changes to our spending or operational plans. We align our export credit support with international agreements that are predominantly decided within the OECD. Those EU regulations that do have implications for how we operate will remain in place while the UK works to establish new relationships with Europe and the rest of the world.

As our Chief Economist makes clear in his report that follows, economic uncertainties always have the potential to affect the demand for our support. It is our responsibility to maintain a broad capability to assist UK exports in all economic weathers. This is what we will continue to do.

Louis Taylor
Chief Executive
30 June 2016

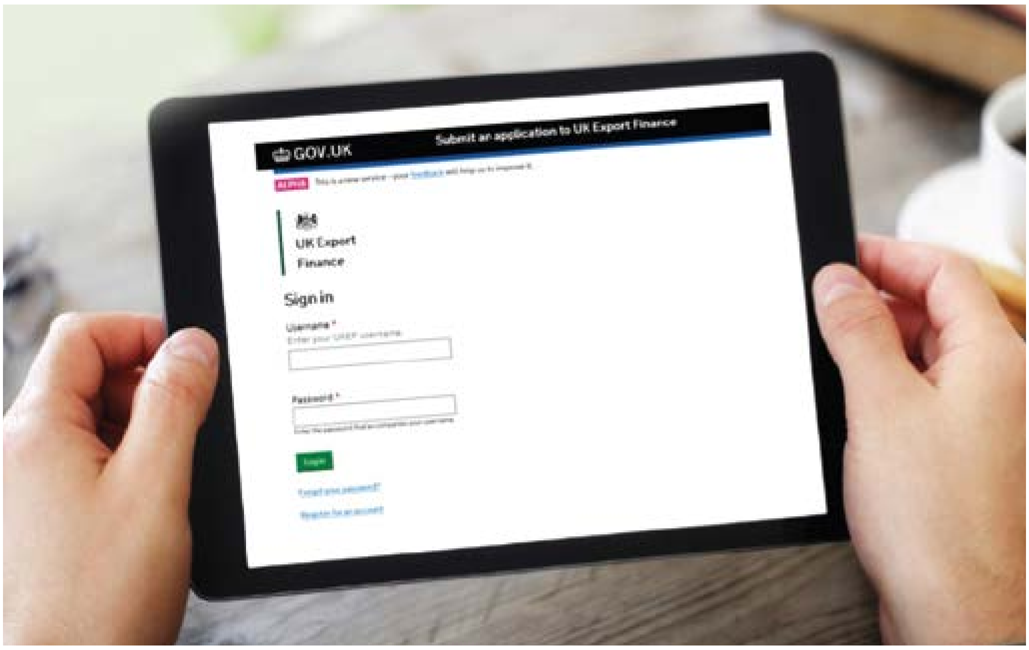


Image UKEF is working with the Government Digital Service and UKTI to streamline and digitise its services

Our growing support for exporters contributes to the government's 2020 Export drive.

Performance overview

Financial overview – 5-year summary					
	2015-16	**2014-15**	**2013-14**	**2012-13**	**2011-12**
	£m	**£m**	**£m**	**£m**	**£m**
Business supported	1,793[4]	2,730	2,272	4,291	2,318
Premium income	73	104	120	133	85
Claims paid	5	6	13	7	6
Net operating income	106	129	50	135	147
Non-financial indicators – 5-year summary					
Total exporters supported, of which:	279	226	130	84	33
direct support under a UKEF product	176	160	130	84	33
private market assists[5]	100	66	not recorded	not recorded	not recorded
direct support and private market assist	3	0	not recorded	not recorded	not recorded
Facilities issued	593	588	619	368	204
Introductions to other sources of support (eg UKTI)	1,778	1,339	not recorded	not recorded	not recorded

4 This figure is issued and effective business net of amounts counter-guaranteed or reinsured by another official export credit agency; it includes £286 million in the form of direct loans and scheduled interest, which is accounted for on a different basis.

5 A 'private market assist' is when our engagement has had a material contribution to a company receiving support from the private sector, resulting in an export contract going ahead that was unlikely to have proceeded otherwise.

Financial objectives	
Objective and description	**Results**
Maximum commitment This measure places a cap on the maximum amount of nominal risk exposure (ie the total amount of taxpayers' money that may be put at risk by UKEF).	**Met** The highest recorded maximum exposure in the year was £21.4 billion, against a notional maximum commitment of £56.2 billion (adjusted for foreign exchange movements).
Risk appetite limit This limit places a constraint on UKEF's appetite for risk at the 99.1 percentile of UKEF's estimated 10-year loss distribution.	**Met** UKEF's 99.1 percentile of the 10-year loss distribution did not exceed £1.3 billion, against a notional risk appetite limit of £3.1 billion (adjusted for foreign exchange movements).
Reserve index This index ensures that UKEF has accumulated, over time, sufficient revenue to cover possible losses, to a 77.5% level of confidence.	**Met** The reserve index did not fall below 4.38 in the year, against a target minimum of 1.00.
Pricing adequacy index This index tests whether, over time, UKEF earns sufficient premium income to cover all its risk and operating costs. It is measured over 3 different periods:	
(i) past 2 years and present financial year:	**Met** This index at 31 March 2016 was 1.37, against a target minimum of 1.00.
(ii) previous, present and next year:	**Met** This index did not fall below 1.28, against a monthly target minimum of 1.00.
(iii) present year and next 2 years:	**Met** This index did not fall below 1.28, against a monthly target minimum of 1.00.
Premium to risk ratio This measure ensures that each year UKEF charges enough premium to cover the cost of risk, together with a sufficient margin to contribute a material amount to administrative costs.	**Met** This ratio did not fall below 1.93, against a target minimum of 1.35.

Note These financial objectives apply to business issued since 1991. There are no specific financial objectives in respect of outstanding exposures on business supported before 1991 other than to recover amounts due in respect of claims paid, in a manner that optimises the return to taxpayer, while taking account of the government's policy on debt forgiveness.

Pages 71 to 79 set out more detail on these objectives.

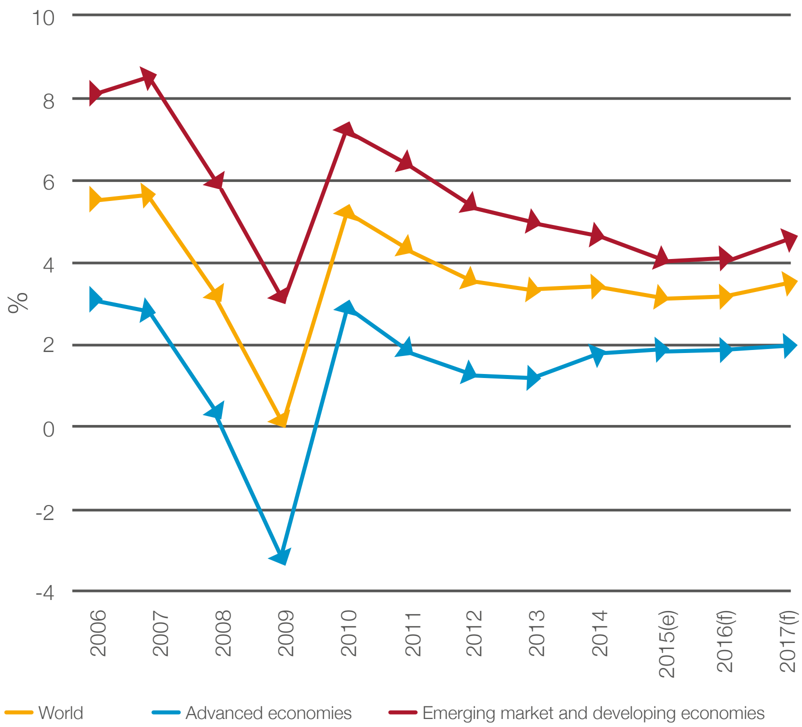
UKEF is based in the HM Treasury building on Horse Guards Road, London.

Chief Economist's report Paul Radford

Slowdown in global activity and improved bank liquidity contributed to a reduction in demand for export credit agency support globally in 2015-16. Demand for UKEF support was no different. A report by Trade & Export Finance (TXF) found that global volumes of all export credit agency deals fell by around a third in 2015 compared with 2014.[6]

World economic growth in 2015 is estimated to have been at around 3.1%, 0.3 percentage points lower than the previous year (3.4%). This fall was driven by slower growth in emerging markets and developing economies (which accounted for approximately 70% of global growth), and lacklustre growth in advanced economies.[7]

Percentage increases in GDP: global



6 *http://www.txf-news.com/News/Article/5453/TXF-Export-Finance-Report-ECA-deal-volumes-drop-by-29* (accessed on 10 March 2016)

7 International Monetary Fund's (IMF) World Economic Outlook (WEO), January 2016

Emerging markets

Growth of economic output in emerging markets fell from 4.6% in 2014 to 4.0% in 2015 with a slowdown in China and South Africa and recessions in Brazil and Russia being the main drivers.

China's economic performance fell from double-digit growth during the 2000s to less than 7% in 2015, as it transitions its economy towards consumption-driven growth with an increased emphasis on services. This has had a knock-on effect on other emerging market economies, especially key trading partners such as Brazil and many African countries, as a result of weaker demand for goods, in particular raw materials and commodities used in manufacturing.

The majority of UKEF support relates to companies exporting to emerging markets. The economic slowdown has had an impact on major projects in some countries, either terminating planned projects or delaying them.

Collapse of commodity prices

The London Metal Exchange (LME) index fell by around 20% year-on-year in 2015 and oil prices decreased by more than 45% from an annual average of US$99 per barrel in 2014 to US$54 per barrel in 2015.[8]

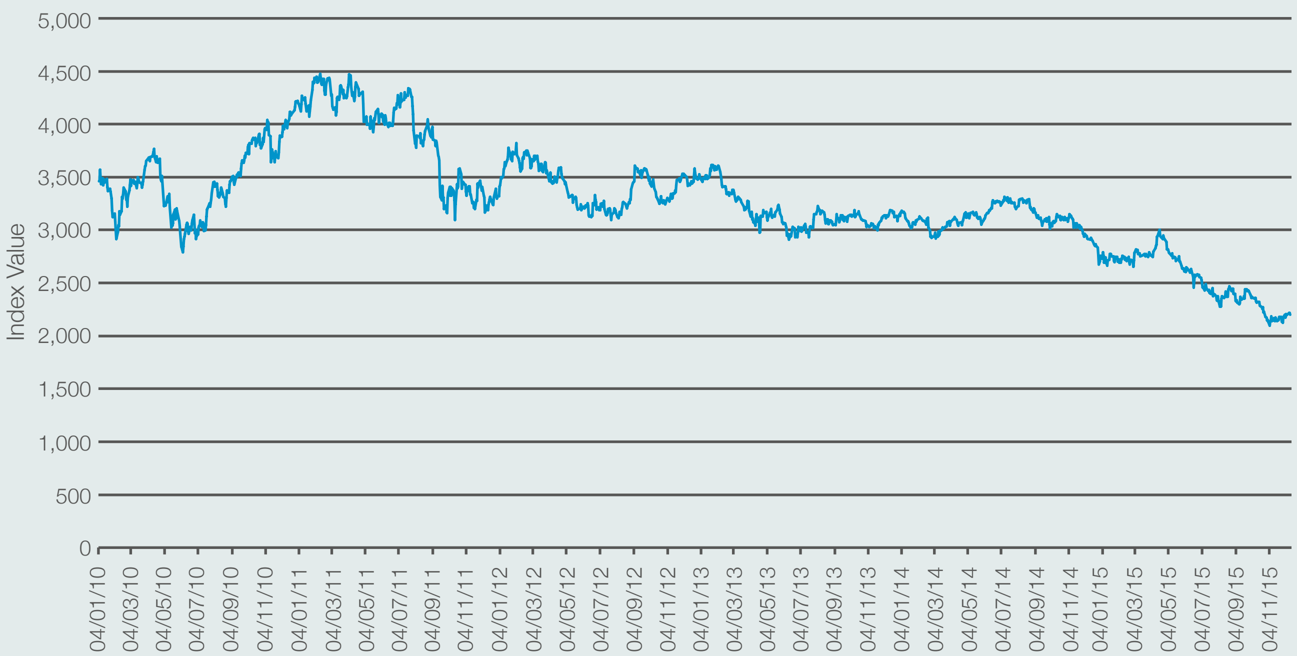
Sluggish demand was not the only reason for the fall in the price of oil. Other factors exerted severe downward pressure on prices, including oversupply of crude as a result of OPEC (Organization of the Petroleum Exporting Countries) members maintaining or growing output, rising US production (in particular shale) and the prospect of Iran re-entering the market.

Sharply lower oil prices have had a negative impact on oil producing countries and many have started to draw on their cash and asset reserves to balance their fiscal budgets. However, the winners have been the importers of oil, such as India.

The decline in commodity prices, in particular oil, has had an impact on investment spending as commodity-producing countries scale back

8 Data sourced from Bloomberg. The LME index in 2014 averaged 3,118 and in 2015 it averaged 2,548. The average price of oil is based on the spot price of Brent oil. The London Metal Exchange LMEX Index is calculated once a day on the basis of the closing prices of the 6 primary metals: copper, aluminum, lead, tin, zinc and nickel. It has a base value of 1,000 starting in 1984.

Metal Exchange Index



infrastructure expenditure. Exporters that specialise in this area tend to rely on export credit finance and, as projects are put on hold due to low prices, demand for support has followed suit.

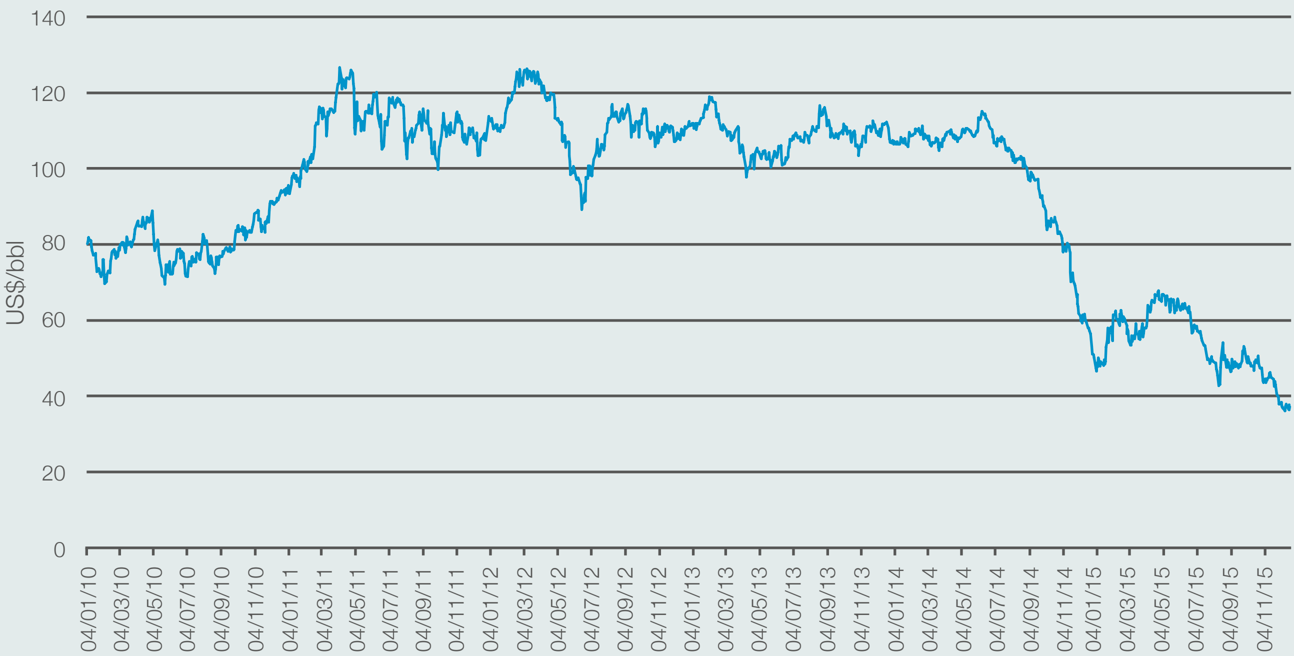
Modest growth in advanced economies

Growth in advanced economies improved marginally from 1.8% in 2014 to 1.9% in 2015. Firmer domestic demand supported economic activity, but net exports remained sluggish, holding back growth. The main exception was the eurozone, which saw net exports rise as a result of the weak euro.

Strong growth in the US saw the Federal Reserve increase the country's key policy interest rate for the first time since 2006. As the market was expecting this event, it did not cause a significant spike in financial volatility. However, it did trigger capital outflows from emerging market economies and the stronger dollar contributed to a fall in US net exports.

The outflow of capital was one of the factors that caused the currencies of many emerging market economies to depreciate, increasing the relative cost of exporting to these regions. There tends to be a time lag between the depreciation of a currency and a fall in demand for external goods. This has the potential to affect demand for export credit agency support.

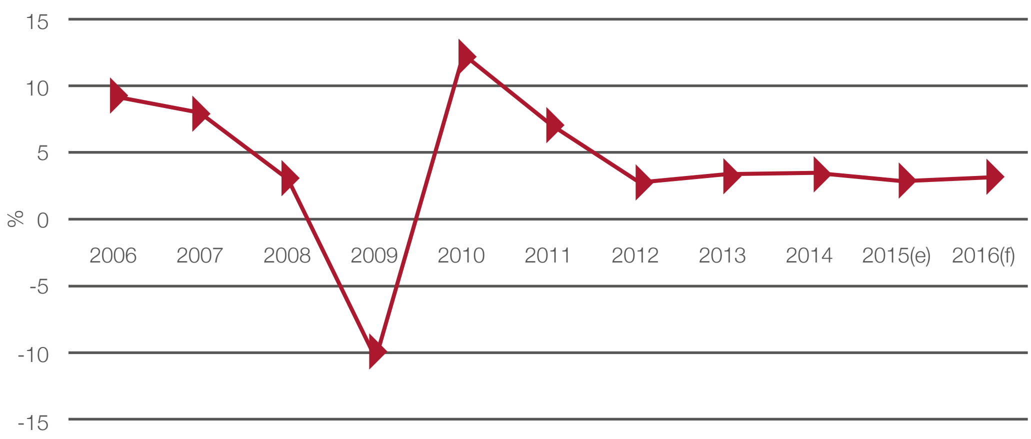
Brent Oil US dollars per barrel



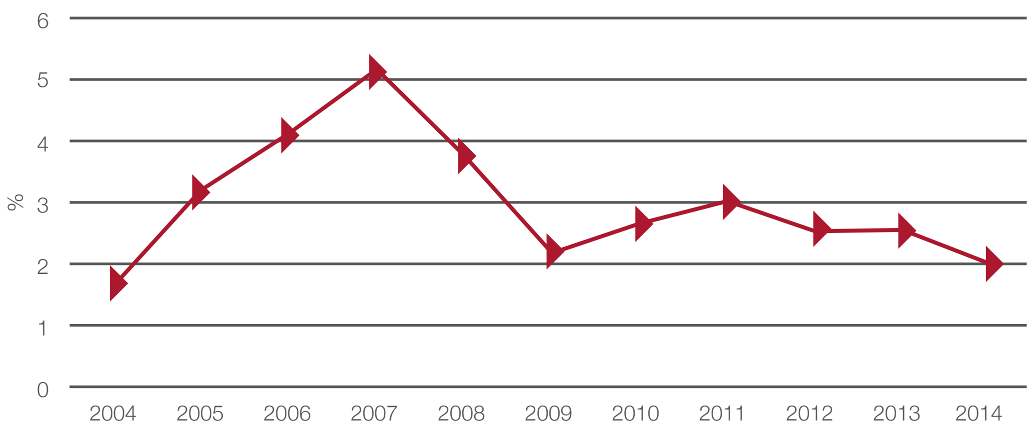
Geopolitical factors

The sanctions against Russia, tensions in the Middle East (such as the war in Yemen and the ongoing threat from Daesh) and security concerns in certain sub-Saharan African countries were some of the main geopolitical risks of 2015. These risks would have had an impact on investor confidence and are likely to have played a part in the slower growth of global trade volumes, which increased by only 2.8% in 2015, 0.7 percentage points lower than in 2014.

World trade: annual growth in volume of goods and services



Foreign direct investment, net inflows (% of global GDP)



An increase in geopolitical risk can result in higher demand for export credit agency support as it is expected to fill the gaps in private sector risk appetite. However, the fall in capital expenditure due to the fall in oil prices is likely to have been a stronger factor behind demand not picking up, despite higher geopolitical tensions.

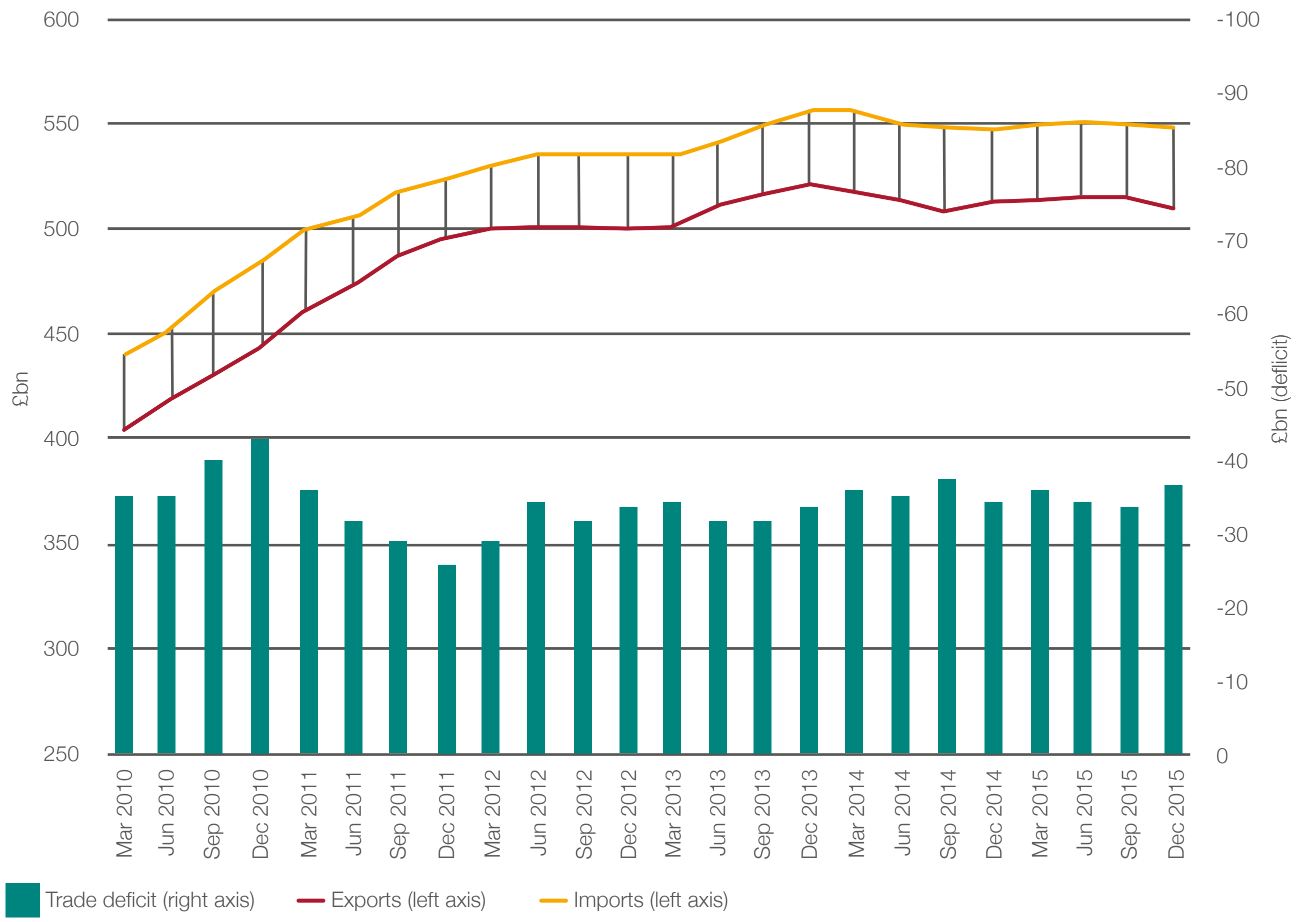
Percentage of Airbus aircraft deliveries with export credit agency support

Export credit agency support was provided for around 6% of the total number of aircraft delivered by Airbus in 2015-16, remaining relatively stable since 2014-15. These low levels of demand for export credit agency support reflect the ready availability of medium- and long-term funding capacity in the commercial bank and debt capital markets. They are also the result of the growth of the aircraft operating leasing market, where competition between the leasing companies has driven down lease rates. The level of demand for export credit agency support is expected to remain low during the next 12 months. However, ongoing volatility in the financial markets and signs of a global economic slowdown may cause restrictions to bank lending, thus reversing this trend. In addition, banks may need to strengthen their balance sheets and adjust to new regulatory requirements including new capital requirements, with the introduction of the Basel III regulations. This could lead to an increase in demand for export credit agency support in coming years.

Domestic factors

The UK exported around £513 billion (£286 billion in goods and £227 billion in services) in 2015, an overall reduction of 0.4% compared with 2014 (around £511 billion). The decline in the exports of goods was much sharper, at around 3%, as a result of lower demand from the European Union (EU), although exports of goods to non-EU countries grew at a modest 2% owing to higher demand from countries such as the US and the United Arab Emirates. However, there were sharp falls in the exports of goods to some of the bigger emerging market economies – for example, goods exports to China decreased by approximately 20% and by a third for both India (33%) and Russia (31%).[9]

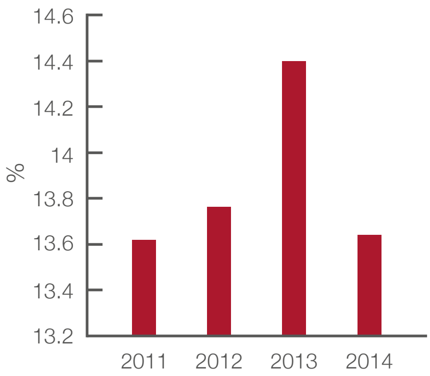
Rolling annual data: UK imports and exports (£bn)



9 Data sourced from the Office for National Statistics (ONS).

The proportion of UK companies exporting has also shown a downward trend. In the 5 sectors that received more than 90% of UKEF support, the proportion of companies exporting fell in 2014.[10] Figures for 2015 are not yet available so it remains to be seen whether this trend will continue.

Proportion of companies exporting within top 5 sectors where UKEF support is most often used



Access to finance

The overall availability of credit for large businesses remained high in 2015, increasing for SMEs,[11] suggesting that companies saw some improvement in access to finance.

However, a 2015 survey by the British Business Bank found that 9% of SMEs cited lack of access to external finance as a barrier to exporting; it also suggested that roughly 1 in 4 SMEs used credit cards to finance their export efforts.[12] This suggests that, in many circumstances, access to finance remains an issue for SMEs.

2016-17 outlook

Global economic activity is projected to pick up slowly, rising from 3.2% in 2016 to 3.5% in 2017. However, downside risks remain from emerging markets being exposed to potential bouts of volatility, to a tightening in financing conditions in global financial markets, to the potential fallout from the Zika virus in South America and to heightened geopolitical risks. Furthermore, major oil exporting countries could see much weaker activity if oil prices remain low for a prolonged period. Therefore, 2016-17 could be another challenging year for UKEF and other export credit agencies. On the other hand, lower oil prices can be seen as an upside risk – it should support global demand and benefit oil-importing economies.

All of this emphasises the need for UKEF to maintain a product suite that can assist exports in all economic weathers.

Paul Radford
Chief Economist
23 June 2016

10 Data sourced from the ONS. The top 5 sectors where UKEF support is most often used are: (1) manufacturing; (2) wholesale and retail trade; (3) professional, scientific and technical activities; (4) construction; and (5) administrative and support service activities.

11 *http://www.bankofengland.co.uk/publications/Documents/creditconditionsreview/2016/ccrq415.pdf* (accessed on 10 March 2016).

12 *http://british-business-bank.co.uk/wp-content/uploads/2016/02/British-Business-Bank-Small-Business-Finance-Markets-Report-2015-16.pdf*. (accessed on 10 March 2016)

UKEF is both a government department and a financial institution, offering loans, guarantees and insurance in support of UK exports.

How we operate

UKEF's statutory purpose is to support exports and overseas investments. We do so principally by providing:

- trade credit insurance to exporters against the risks of non-payment for amounts owed under export contracts
- guarantees to banks to support working capital financing and raising of contract bonds on behalf of exporters
- guarantees to banks and investors in the debt capital markets in respect of medium- or long-term loans to overseas buyers who purchase goods and services from UK exporters
- lending directly to overseas buyers who purchase goods and services from UK exporters
- political risk insurance for investments made overseas

UKEF supports exports of all types of goods and services and can help businesses of all sizes that seek protection from the financial risks of exporting.

In doing this, our role is to complement the private market: we seek to support exports that might otherwise not happen, thereby supporting UK exporters and indirectly their supply chains. The space in which we operate is therefore largely determined at any one time by the willingness and capacity of the private market to assume financial risks in support of exports. We are also bound by EU restrictions on member governments supporting short-term export credit insurance for exports to EU countries (currently excluding Greece) and rich OECD countries (eg the US).

The financial liabilities we assume when supporting exports involve a risk transfer from the private to public sector (ie the UK taxpayer). Direct lending involves upfront public expenditure while other financial liabilities represent contingent public expenditure – that is, taxpayer funding is required in the event of claims being made under contracts of insurance issued to exporters and guarantees provided to banks. Where claims are made, we then instigate recovery action as appropriate on a case-by-case basis or, where there is a sovereign default, through the Paris Club of official creditors to recoup the relevant payments.

UKEF operates under the consent of HM Treasury, which sets financial objectives that it must achieve. These include an exposure cap, a portfolio risk appetite limit and a requirement that premiums meet credit risk and operating costs. To this end, we operate credit risk and pricing policies that inform our ability to underwrite individual export transactions.

We also operate under international agreements that set the terms under which export credit agencies can support exports and which, thereby, seek to create a "level playing field". These agreements emanate principally from the OECD. Not all export credit agencies, however, subscribe to these international agreements and competition for UK exporters is increasingly from non-OECD countries, whose export credit agencies are not bound by the OECD.

Principles applied by UKEF

On individual cases, we aim to:

- provide a quality of service that is proactive, flexible and efficient, with a focus on solution and innovation
- take account of factors beyond the purely financial, and of relevant government policies in respect of environmental, social and human rights impacts, debt sustainability, and bribery and corruption

Generally, we aim to:

- publish, for the benefit of applicants, guidance on the processes and factors we take into account in considering applications
- disseminate information about our products and services
- achieve fairer competition by seeking to establish a "level playing field" internationally, through obtaining multilateral agreements in export credit policies and practices
- recover the maximum amount of debt in respect of claims paid, taking account of the government's policy on debt forgiveness
- abide by such codes of practice and guidelines on consultation as may be published by the government from time to time
- employ good management practice to recruit, develop and retain the people needed to achieve our business goals and objectives

Our export solutions

Our support for UK exports can be categorised into long-term support (**export credit**) and short-term support (**trade finance**).

Export credit support typically covers exports of capital/semi-capital goods and related services (eg large projects, high value machinery). Because of the high values involved (normally £5 million to £1 billion plus), overseas buyers frequently require loans (usually repayable between 5 and 12 years or more) to finance the purchase of such supplies from UK exporters. We provide support under our finance products (such as its buyer credit guarantee) to banks that provide export credit loans, thereby covering the risk of default by borrowers. Alternatively, we can lend to buyers directly.

Trade finance support typically covers consumer or intermediate goods and services (eg consumer durables, light manufactures). Typically, such exports are sold on short credit terms (up to one year), which exposes exporters to (a) risks of non-payment, and (b) the need to finance working capital (pre-shipment financing) and the credit period (post-shipment financing). We have products designed to meet these challenges.

Export solutions

Longer term credit (2 to 18 years)	**Export credit solutions:** supporting finance for overseas buyers of UK exports	• Providing guarantees to banks on the loans they give to overseas buyers to purchase goods and services from the UK • Direct lending to overseas buyers so that they have the funds to purchase goods and services from the UK	• Buyer credit facility • Supplier credit facility • Direct lending	Lower volume, higher value
Shorter term credit (less than 2 years)	**Trade finance solutions:** supporting UK exporters	• Reducing or removing the risk of non-payment by overseas buyers • Helping to support a cash bond offering which is a requirement of the contract • Assisting with working capital requirements	• Export insurance • Export working capital • Letters of credit guarantee • Bond insurance • Bond support	Lower value, higher volume

Manufacturers made up 57% of the companies we supported in 2015-16.

Our support for exports

Business supported	
Exporters supported:	279
Value of support provided:	£1.8 billion
Destination countries:	69
Smallest case:	£4,489 (Bond support)
Largest single facility:	£167 million (drawdown on a line of credit)
Most popular product:	Bond support (110 companies)
Highest value product:	Buyer credit guarantees (£1,394 million)

Image Lord Price, Minister for Trade and Investment, outside the mobile export 'hub', which is touring the UK providing advice and support to UK businesses.

Focus on trade finance and insurance solutions: making exports happen

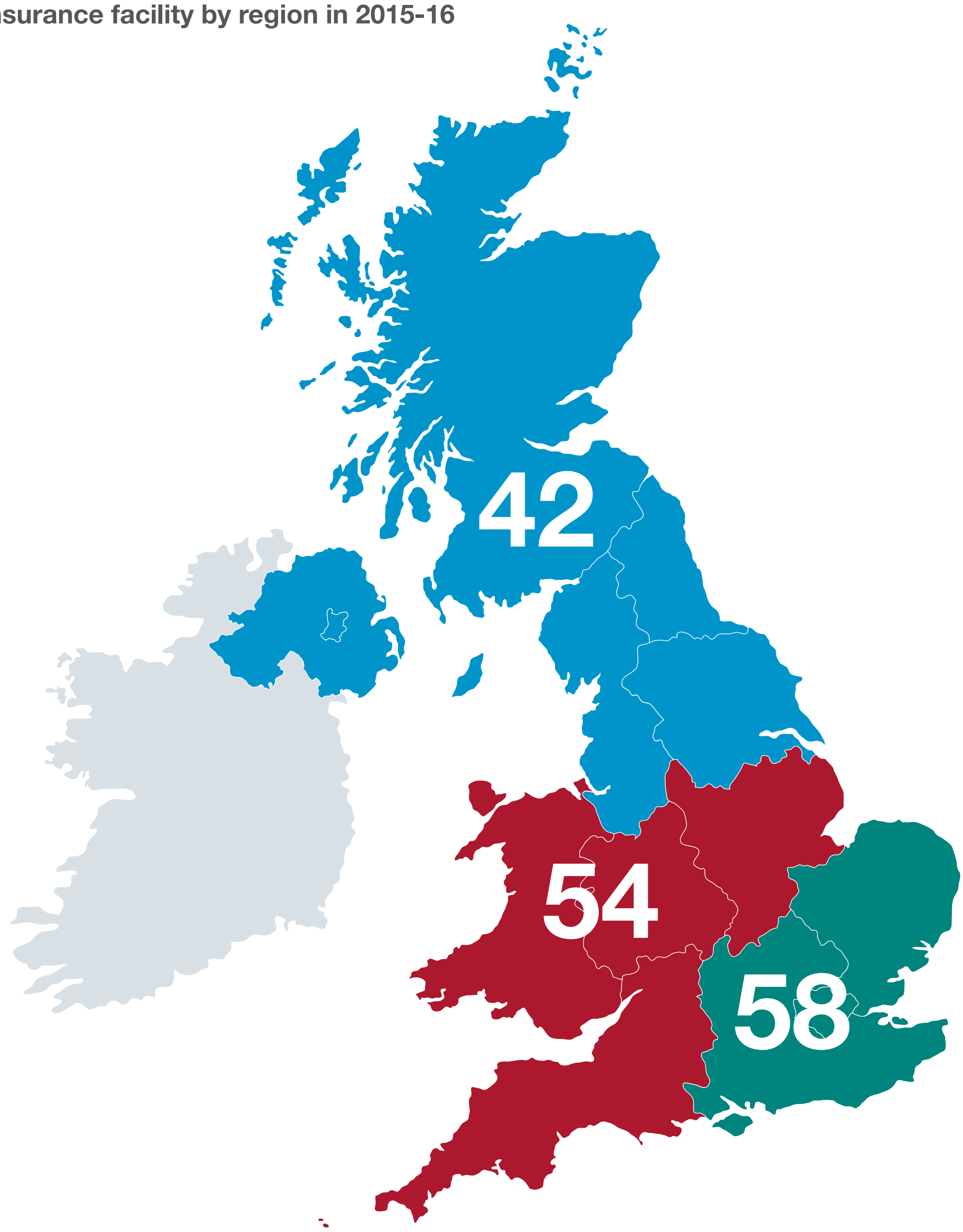
We use our trade finance and insurance support to:

- provide insurance to exporters, principally against the risk of non-payment
- help UK-based companies access trade finance facilities, such as contract bond guarantees or working capital loans, by providing guarantees to their lenders

In 2015-16 we supported £800 million of export contracts through our trade finance products. Smaller (SME) companies accounted for 77% of this contract value. We also helped 103 companies find the finance or insurance they needed from the private market.

UKEF has now supported more than £3 billion in export contracts since our trade finance solutions for smaller companies were introduced in 2011.

Number of companies benefiting from a trade finance or insurance facility by region in 2015-16



Our support can help transform companies' export performance: each of the companies we helped to access trade finance or insurance in the year has their own success story to tell.

They include winners of the Queen's Award for Enterprise. Others featured in the Sunday Times Fast Track 100 league table, which ranks the fastest-growing SME exporters in the UK. Their growth adds to the UK's prosperity, bringing jobs and opportunity across the country.

Support for contract bonds

Blyth Workcats is typical of the success stories we've been pleased to contribute to in the year. It is a specialist designer and builder of catamarans based in Canvey Island, Essex. For more than 20 years it has produced tailor-made boats for a variety of different roles. These include fishing and sightseeing vessels, and work boats for surveying or offshore construction.

When Blyth's buyer in Germany required an advance payment bond that had to be guaranteed by Blyth's UK bank, the bank did not have the risk capacity necessary to guarantee 100% of the bond and provide Blyth with working capital to fill the German order. So UKEF issued a guarantee to the bank for half of the advance payment bond and liberated enough risk capacity to allow the bank to provide the necessary working capital.

"UKEF support was paramount for the project... Our bank couldn't cover 100% of the risk for the bond. Thankfully UKEF was able to take on 50% of the risk. We couldn't have gone ahead without it."

Stuart Davidsen, Production and Design Manager at Blyth Workcats.

Image Model of a 10-metre Blyth Workcats catamaran being built in Canvey Island, Essex, for scientific survey work in the Kiel Canal, Germany.

Protection against non-payment

We were able to help others insure against the risk of non-payment when cover was unavailable from commercial insurers.

London-based ES Global Solutions was asked to provide a £400,000 temporary triathlon track for pre-Olympic testing on the celebrated Copacabana beach in Brazil. With annual sales of around £8 million and 28 employees, the company needed to be confident of full payment as the contract was significant. Having been unable to find insurance from the commercial market, the company found the cover it needed through our export insurance policy.

Export insurance: top 10 markets in 2015-16

1.	Russia
2.	Greece
3.	United Arab Emirates
4.	Ukraine
5.	Nigeria
6.	Kenya
7.	Belarus
8.	Brazil
9.	China
10.	Turkey

Image ES Global's temporary triathlon track on Copacabana beach.

Customer profile: Glasscoat International

A UK SME selling machines to Germany.

- **Number of employees:** 10
- **Turnover:** £1.4 million
- **Revenue from overseas sales:** 95%
- **Number of overseas markets:** 14

Ian Cripps, whose background is in the electronics industry, founded Glasscoat in 1993 to fill a gap in the market when he realised that UK cosmetics manufacturers had to import coloured glass bottles from Europe.

Glasscoat's first export was in April 1999, when it entered into a contract to supply a glass coating machine to the South Africa-based sister company of a UK client. This first export gave Cripps the confidence to look for other overseas buyers. Later the same year, he supplied a machine to a company in Italy that manufactured bottles for popular rum brand Malibu, and overseas sales have expanded ever since.

With international success came a difficult choice. Last year Glasscoat won 2 contracts, one in Austria and the other in Germany. In both cases, Cripps negotiated upfront payments to fund the purchase of components. However, both buyers requested advance payment guarantees from Glasscoat's bank, in return for which the bank required cash collateral as security. Providing the deposit for guarantees to both clients would have restricted the company's working capital, leaving it unable to fulfil both contracts. Cripps found that he might need to turn down one of the contracts.

On the advice of his bank, and the local chamber of commerce, Cripps approached UKEF for support. Under its bond support scheme, we provided a guarantee to the bank to cover 80% of the bond, thus enabling the bank to release £370,000 in cash to Glasscoat to use as vital working capital. This did not cost the company any more as we take a share of the bank fees and do not charge the exporter to issue the guarantee. Accessing our support was hassle-free, and Cripps said he wouldn't hesitate to ask us for support in future.

"Selling machines to Germany felt like I'd succeeded in selling coal to Newcastle," said Cripps. "And without UKEF's support, we could not have fulfilled both contracts, and we would have had to turn away a customer.

"Working with UKEF meant that we were able to sell a machine in Germany and increase our revenue by £710,000."

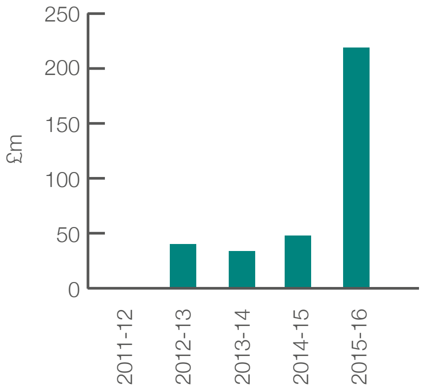
Image One of Glasscoat International's machines at work.

Image Oyster Yachts of Southampton was founded in 1973 and has established itself as an exporter of cruising yachts. We helped it secure an advance payment from a buyer of one of its newest models.

Growth in working capital support

The year 2015-16 saw a significant increase in the value of contracts supported via our export working capital guarantees. We expect this trend to continue as we work with banks to enhance our working capital support in 2016-17.

Export working capital support (contract values - £m)



This scheme benefited companies such as Unit Birwelco. Based in Swansea and providing engineering and project management services in the power and petrochemical industries, Unit Birwelco's exports account for almost 25% of its sales to markets as varied as Russia, Indonesia and Malaysia.

Our involvement has been critical in assisting the successful delivery of the company's design and engineering knowhow and expertise to customers overseas. In 2015-16 we enabled Unit Birwelco's bank to issue a £750,000 performance bond together with a £2 million working capital facility relating to the export of industrial heaters.

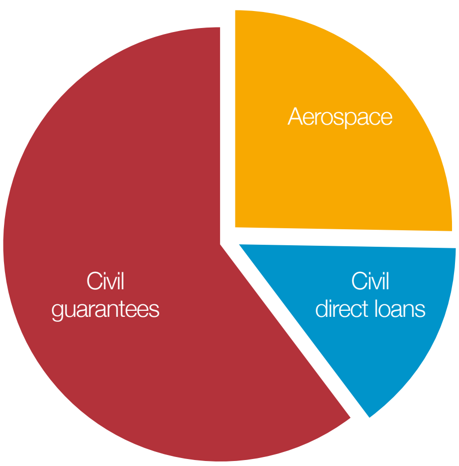
Image A Unit Birwelco fired heater module is prepared for export.

Focus on export credit support: helping the UK compete in the global marketplace

Export credit support is when UKEF funds or guarantees long-term loans used to purchase capital goods and services from the UK.

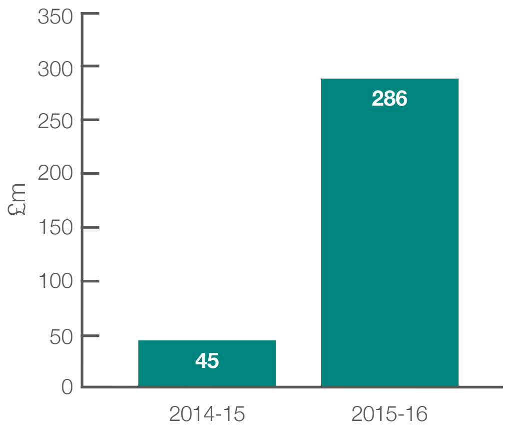
Export credit business supported 2015-16

Sector	UKEF maximum liability, £m
Defence	0
Aerospace	497
Civil - direct loans	286
Civil - guarantees	896



Direct lending

Our £3 billion direct lending facility was announced in the 2014 Budget. In 2015-16 the value of direct loans made to overseas buyers of UK exports grew more than five-fold to £286 million.



The first loan of 2015-16 was a €23 million loan to Kayali Enerji Uretim of Turkey to help finance the provision of a 77MW gas-fired power station to produce electricity for 150,000 homes.

This was the first UKEF loan facility to be entirely funded by direct lending. It supported contracts won by Industrial Turbine Company (UK) to supply a gas turbine and by General Systems Design UK to supply a heat recovery steam generator.

Shortly afterwards, a US$67 million loan was issued to support a contract won by Primetals Technologies, to supply and install essential equipment in the upgrade of a steel mill in Saskatchewan, Canada. Primetals Technologies is a UK company with its headquarters in London and engineering, design and manufacturing capacity at several other locations in the UK including Stockton-on-Tees, Sheffield and Scunthorpe.

Two more direct loans were underwritten during the year to support construction work being undertaken by UK companies in Dubai. The first of these (US$317.9 million) was in respect of a contract awarded to Kier Group to provide infrastructure and residential apartments at Meraas Holding's Blue Waters Island development. The second loan (US$177 million) helped Carillion Construction secure further work to develop the Dubai World Trade Centre with the provision of office buildings and infrastructure. These 2 loans consisted of a mixture of UKEF and commercial bank funding.

Buyer credit loan guarantees

Following the US$1 billion line of credit issued in 2012 to Petrobras of Brazil, a further line of credit of US$500 million was issued during the year.

Approximately £260 million of this was used by Petrobras to purchase UK supplies from Subsea 7 International Contracting and Wellstream International (a GE company).

GE co-operation framework

In September 2015, UKEF and GE signed a cooperation framework. The first product of this was our support for exports from Wellstream, a GE-owned UK company.

Future business to be considered under the new framework, which could support up to 1,000 new jobs in the UK energy sector, includes solar power generation and oil- and gas-related export opportunities in Brazil, Egypt, India and sub-Saharan Africa.

Image Carillion are helping the construction of the Dubai World Trade Centre complex.

“Export finance is a critical tool we use to support our customers. We are fortunate to have the support of UK Export Finance - one of the most flexible ECAs in the world.”

Jeff Immelt
GE Chairman and CEO
24 September 2015

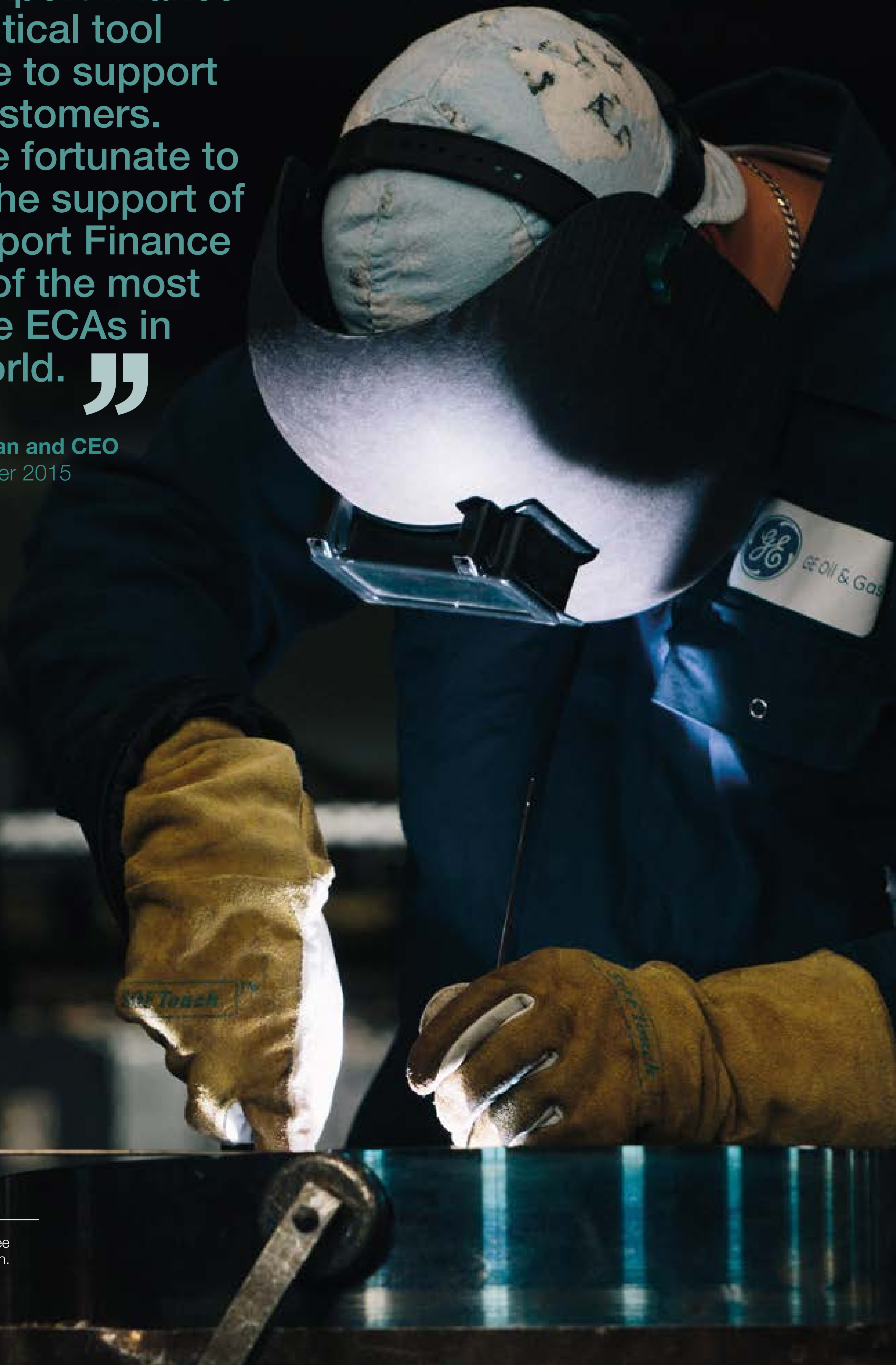


Image GE employee at work in Aberdeen.

UKEF also provided counter-guarantees to Atradius of £57 million for the UK element of a floating production, storage and offloading unit to be deployed in the Santos Basin off the coast of Brazil. The project involves the conversion of an existing tanker, the Cidade de Saquarema. More than 40 UK contractors were involved in supplying goods and services to the main contractor, SBM. The contract will be funded by a 20-year charter to process and deliver oil.

UKEF provided counter-guarantees to the export credit agency of the Netherlands for the UK content in 2 pipe-laying vessels – the Jade and the Onyx – constructed by IHC Engineering Business. The total amount of UKEF support provided for these vessels amounted to £110 million.

During the year, Reliance Industries drew £146 million from its UKEF line of credit, which we established to support 7 UK companies supplying goods and services to the Jamnagar oil refinery in India.

We issued a guarantee for an €85 million loan for the financing of an iron plant to be constructed by Midrex UK at an existing facility in south-west Russia.

Support continued for the ongoing contract between Fluor and the Sadara Chemical Company for their petrochemical project in Saudi Arabia. Two contracts, totalling £14.4 million, were covered for this project.

We also provided a counter-guarantee to our Italian counterpart, SACE, for the UK element of a glass container production plant built at Bozuyuk in Turkey.

Image The pipe-laying vessel Sapura Jade.

Asset-backed finance: aerospace

In 2015-16 UKEF issued £497 million of support for the delivery of 32 Aribus aircraft to 12 airlines and leasing operations around the world.

The UK-made proportion of an Airbus aircraft can be up to 38%, depending on the aircraft type and engine. If Rolls-Royce engines are fitted, our support is increased accordingly. Our support benefits the Airbus operations in the UK and indirectly benefits a large number of other companies, including many SMEs in the supply chains of both Airbus and Rolls-Royce.

UKEF support for the export of Airbus aircraft is provided alongside that of the French and German export credit agencies, with each agency supporting a percentage of the financing cost of the aircraft broadly in proportion to the percentage of the aircraft manufactured in each country.

Typically one of the 3 export credit agencies will lead a transaction, with the other 2 providing counter-guarantees.

In March, Airbus disclosed there had been a number of inaccuracies relating to its historical use of overseas agents in its applications to UKEF for support. UKEF referred this information to the Serious Fraud Office and has since advised Airbus it is unable to support the delivery of further Airbus exports pending the outcome of enhanced due diligence in accordance with the requirements of the OECD Recommendation on Bribery and Officially Supported Export Credits.

Airbus: UKEF lead support and counter-guarantees issued in 2015-16

Another year of innovation

Renminbi support: a historic currency boost

Thanks to UKEF, Chinese buyers of UK exports can now access UK government-supported loans in their own currency.

The UK government shares the City of London's ambition to make London the world's leading centre for offshore renminbi (RMB) business outside China. The RMB has in recent years overtaken the euro as the second-biggest trade finance currency after the US dollar.

The first company to benefit from UKEF's support for RMB loans was Airbus, which supports 100,000 jobs in the UK. With UKEF's help, Airbus's Chinese customer, the airline China Southern, was able to access from HSBC a 12-year UKEF-guaranteed loan in RMB, which it used to purchase a new A330 aircraft. This was attractive for the airline as 97% of its revenues are in RMB.

Opening the door

This work has opened the door to future export business being supported by UKEF in RMB. The flexibility on the loan currency will help make it more attractive for Chinese companies from any sector, and companies outside China that generate revenues in RMB, to buy from companies operating in the UK.

Announcing the support for Airbus and China Southern, the UK Chancellor of the Exchequer reflected on the scale of this new opportunity.

Chancellor of the Exchequer, the Rt Hon George Osborne MP, said:

> **"This is a truly historic deal which paves the way for the best British companies to export much more easily to the Chinese market."**

UKEF's financing of an A330 aircraft in Chinese RMB for China Southern Airlines, completed in June 2015, was the first financing by any export credit agency in the Chinese currency. It has been nominated for Air Finance Journal's 2015 Deal of the Year. With the Chinese aircraft market expected to be worth US$600 billion over next 20 years, there is a strong prospect of further deals to be financed in RMB in the future. UKEF is able to support financings in a wide range of currencies. In our view, allowing importers to buy UK goods in their own currency encourages more export deals.

Image Chinese 1 RMB banknote, by Nayu Kim/Flickr. creativecommons.org/licenses/by/2.0.

Award-winning thought leadership in Islamic financing

Our support for the first-ever export credit agency-backed Islamic sukuk widens the options for buyers of UK exports.

Between April and July 2015, the department supported the delivery of 4 A380 aircraft to Emirates, financed by the first-ever export credit agency-backed Islamic sukuk. This deal was the first transaction to be financed through a pre-funded bond issue, in which the proceeds were raised before the aircraft were delivered. It was also the largest aircraft transaction supported by an export credit agency. The UKEF-guaranteed sukuk has been widely commended for its innovation and has won a number of industry awards, including:

- Trade and Export Finance Deal of the Year at the Bonds & Loans Awards
- Bonds, Loans & Sukuk Awards – Middle East 2015
- Global Transport Finance's Islamic Finance Deal of the Year
- Islamic Finance's Cross Border Deal of the Year
- United Arab Emirates Deal of the Year
- Airline Economics' Middle East Deal of the Year
- The Banker's Middle East Deal of the Year: Securitisation and structured finance.

New refinancing product

UKEF worked with the French and German export credit agencies and Citibank to create a new refinancing product, whereby the original loan used to finance an export is securitised after delivery, partially or in full, in the capital markets. This new product allows debt capital markets investors to invest in export credit agency-guaranteed bank loans without many of the costs and administration required for a debt capital markets bonds issuance. The first transaction, which was used to refinance an A380 aircraft, was completed in October 2015.

This product widens funding sources for export credit transactions as it allows institutional investors without the capacity to make loans on their own behalf, such as pension funds and insurance companies, to invest in aircraft loans. It also allows banks to clear loans from their balance sheets, releasing capital to finance new exports. It will help to maintain the availability of export finance funding for new transactions when the new capital requirements associated with the Basel III regulations take effect, as the institutional investors investing in this product will be unaffected by the new regulations.

New aircraft types

In September and October 2015, UKEF supported the delivery of 2 A350 XWB aircraft with Rolls-Royce engines to AerCap, the world's largest aircraft leasing company. The A350 XWB is Airbus's newest aircraft type, and entered commercial service in January 2015. The aircraft are being operated by Vietnam Airlines, the second airline to add the

> **"This success reaffirms UKEF as the thought leader among European export credit agencies and once again shows UKEF's remarkable ability to innovate in the face of changing market needs."**
>
> **Munawar Noorani,** Managing Director, Citi

A350 to its fleet. The A350 is a wide-body aircraft, powered exclusively by fuel-efficient Rolls-Royce engines, and the first Airbus with both fuselage and wing structures made primarily of carbon fibre, making the aircraft lighter and more fuel efficient.

UKEF is also working with its Canadian counterpart, Export Development Canada, to support deliveries of Bombardier's new C Series jet aircraft, which is due to enter service in mid-2016. We expect to provide support for our first aircraft before the end of 2016. Bombardier builds the composite wings for all C Series aircraft in Belfast.

Export finance advisers

Our 23 regional export finance advisers act as local points of contact to introduce exporters and businesses with export potential to finance providers, credit insurers, insurance brokers, trade support bodies and sources of government support.

The export finance advisers' year in numbers:

103
private market assists – when their engagement has had a material contribution to a company receiving support from the private sector, resulting in an export contract going ahead that was unlikely to have proceeded otherwise

376
referrals to UK Trade & Investment, Scottish Enterprise, Business Wales or Invest Northern Ireland

8
UKEF staff gained the Institute of Export's Level 5 Diploma in International Trade. All our Export Finance Advisers are expected to seek this qualification

1,817
meetings with intermediaries (eg banks, brokers, accountants)

2,966
meetings with businesses

1,402
referrals to other third-party sources of support

UKEF works in partnership with a wide range of commercial finance and insurance partners.

Our partners and operations

Partnerships

UKEF has a network of partners without whom it could not operate. Our approach is to collaborate as generously and purposefully as we can with these partners to improve the support we provide.

Image George Otieno, CEO of the African Trade Insurance Agency, welcomes UKEF as ATI's newest member in the presence of British High Commissioner to Kenya, Nic Hailey.

- In August 2015 London Forfaiting Company joined our bond support scheme.
- We have worked with the British Bankers' Association to develop our trade finance products to give lenders more control over the application process and to widen the applicable scope of our support.
- In May 2015 we published a navigable guide for brokers on arranging cover for their clients using our export insurance.
- In March 2015 we agreed a partnership arrangement with the Export Guarantee Fund of Iran to work together to identify opportunities for trade in capital goods, equipment and services between the 2 countries.
- In March 2015 we agreed a framework with China Export & Credit Insurance Corporation (Sinosure) for strengthened co-operation, paving the way for increased UK and Chinese exports.
- In March 2015 we become the newest member of the African Trade Insurance Agency, offering UK exporters enhanced access to growing markets in Africa.
- In November 2015 we worked with UKTI to launch the Exporting is GREAT campaign, presenting real-time export opportunities that businesses can apply for online.
- We worked with HM Treasury to agree our spending plans through to 2020.
- We worked with the Government Digital Service to complete the 'alpha' prototype phase on a new application service.

Operations

This was the final year of the 2010 Spending Review period, which saw UKEF complete a number of cost-saving efficiencies, including our relocation to 1 Horse Guards Road, the closure of our site in Cardiff, the renegotiation of a number of IT contracts, and the end of a contract with Lloyds to administer direct funded loans.

In 2015-16 we implemented new electronic case management and customer relationship management systems. We also began development of a workflow system that will provide cost-effective support for an increased uptake of our products and services. A customer application service will be launched as a beta (trial) service in 2016-17.

We began a pilot model for delegating decisions on trade finance products to banks based on defined credit metrics, to improve efficiency and turnaround times and to cope with anticipated increases in volumes. If the pilot is successful, this model will be rolled out to all our partner finance providers.

In reaching agreement for the 2015 Spending Review, we have outlined plans to streamline our activities, with savings being reinvested to improve our business processes. This will cover 3 broad areas:

1. **Organisation and workforce:** to bring together functions and rationalise structures, management layers, and processes.
2. **Technology, data and targeting:** to improve services and drive efficiencies through a digital transformation programme, drawing on the government's Digital by Default service standard.
3. **Service redesign:** focused on working with partners to develop simpler, faster and more scalable service models, built around the needs of the customer.

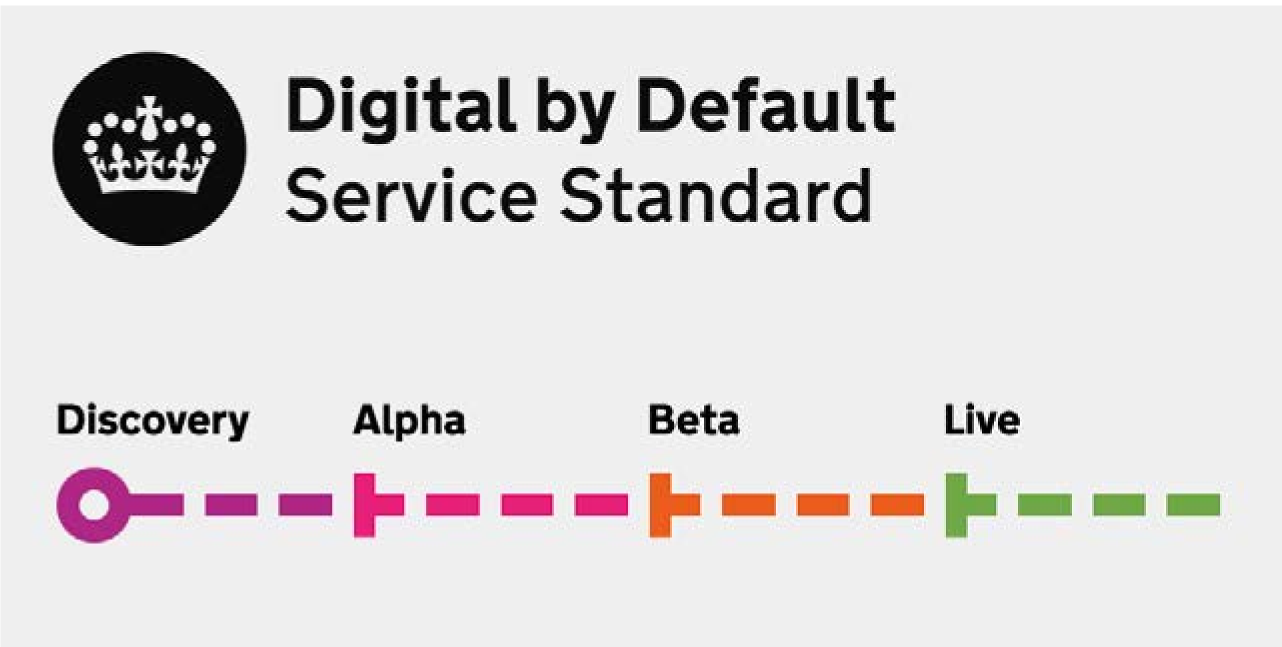


Image UKEF follows the 4 design stages recommended by the Government Digital Service: researching user needs (Discovery); prototype of solutions (Alpha); development in a live environment (Beta); and releasing a fully live service (Live).

Exposure to the civil aerospace sector remains UKEF's largest risk concentration.

Financial risk review

Principal financial risks

Credit risk: the risk of financial loss if an obligor or counterparty against which we have financial exposure fails to meet its contractual obligations. This is our principal financial risk.

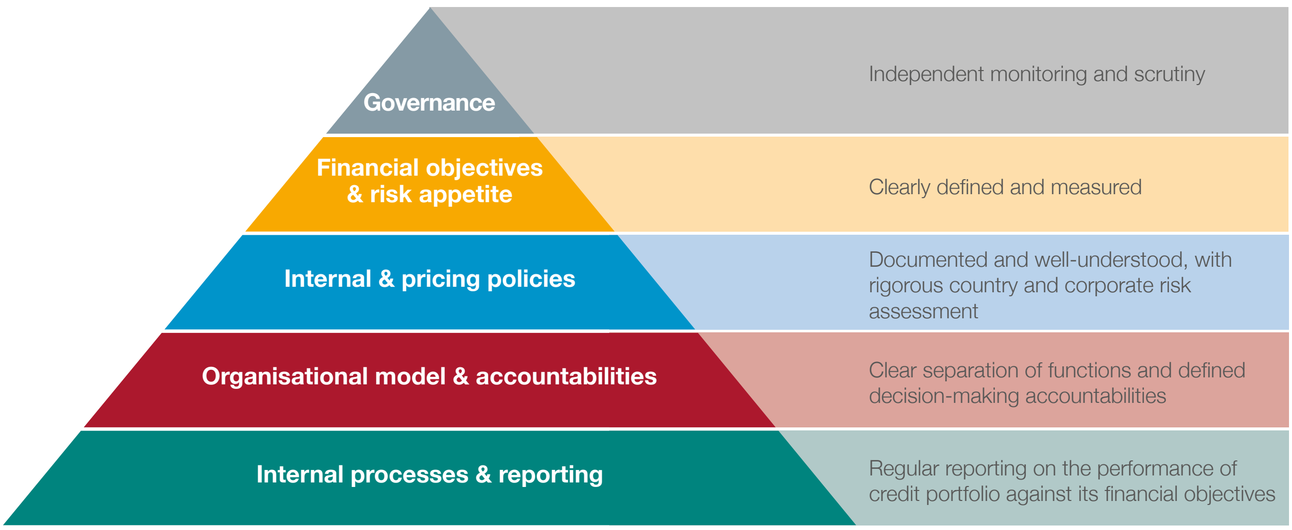
Market risk: the risk of losses arising from movements in market prices. For example, this risk arises with changing foreign exchange rates and, to a much lesser extent, changing interest rates.

Liquidity risk: the risk that we do not have the financial resources to meet our obligations as they fall due, or can secure those resources only at excessive cost. However, UKEF's status as a government department enables us to obtain public funds.

Our principal financial risks are credit risk, market risk and liquidity risk. To manage them we aim to match, or exceed, the best practices in the financial services industry.

Given our role as a government-backed export credit agency, the relative importance of these risks differs from that observed in many private sector financial institutions. Credit risk is the most significant risk for UKEF. Its management is a core competency for the department. Our credit risk management framework reflects this, operating at a variety of levels within the department as set out below.

Similar principles apply to the management of other financial risks to which UKEF is exposed, though the detailed frameworks differ for each category of risk.



Credit risk management

Context

Credit risk is the risk of financial loss if an organisation against which we have financial exposure fails to meet its contractual obligations. In general, this crystallises when we pay claims under guarantees or insurance policies we have issued. Claims are triggered by defaults on payments due to the guaranteed or insured party (usually the exporter or the bank supporting the export contract). They may also arise through our direct lending and legacy interest rate hedges in the event of our borrower or hedge counterparty defaulting.

While we do compare our credit risk management with what we consider best practice in the financial services industry, as the UK's export credit agency we have a different role, mandate and risk appetite from private sector financial institutions. Accordingly, a direct comparison with all the metrics used by regulated commercial entities can be misleading as the credit portfolios of export credit agencies will tend to be characterised by:

- a higher risk profile
- a strong focus on emerging market risks
- longer risk horizons
- greater risk concentrations

Credit risk governance

Parliament sets an overall limit of SDR[13] 67.7 billion on the commitments that UKEF may enter into. UKEF's powers may only be exercised with the consent of HM Treasury. The limits of this consent are agreed with HM Treasury, along with financial objectives and reporting requirements that serve to regulate our assumption of risk.

Ultimate responsibility for credit risk management within UKEF lies with the Chief Executive, as Accounting Officer, who is answerable to ministers and Parliament for all aspects of the department's operations. With regard to credit risk, the Chief Executive is supported by a number of committees (principally the Credit Committee) and the department's risk management activities are subject to independent monitoring and scrutiny.

The UKEF Board (led by a non-executive chairman) provides independent advice, scrutiny and challenge to the Chief Executive across a broad range of areas including risk management. The board typically meets 8 times a year. A sub-committee of the board, the Audit and Risk Committee, composed of non-executive directors, separately examines and reviews the adequacy of risk management and controls across the department. Meetings of the Audit and Risk Committee, of which there are typically 5 a year, are attended by an official from the National Audit Office.

HM Treasury officials monitor the department's performance against its financial objectives. UK Government Investments (UKGI), which replaced the Shareholder Executive, provides advice to the Secretary of State on the exercise of ministerial responsibility for UKEF. While UKGI does not have any executive powers over UKEF's operations, its officials review the department's risk management function and processes to ensure that risk and internal control are managed effectively.

13 This limit is expressed in special drawing rights (SDR), an international reserve asset created by the IMF.

Within UKEF, the Credit Committee is responsible for the effective approval, management and monitoring of credit risk exposures at the transaction and portfolio level, advising the Chief Executive accordingly. It is also responsible for credit risk policies and for ensuring that credit risks are properly monitored and controlled through UKEF's processes and systems. It is scheduled to meet weekly, if required, but can be convened on an ad hoc basis to consider urgent business. Routine submissions can be handled by written procedure. The members of the Credit Committee are the Chief Executive, the Credit Risk Group Director (chair), the Chief Financial Officer, the Head of Business Group, the General Counsel (or nominee), and divisional heads responsible for country risk assessment, corporate risk assessment and risk pricing/portfolio risk respectively. A quorum requires at least 3 members, including one of the Credit Risk Group Director, the Head of Risk Assessment Division or the Head of Business Group.

Financial objectives and appetite

UKEF's financial objectives are designed to enable it to fulfil its risk-taking mandate while ensuring that this activity:

- is undertaken on a basis that adequately rewards UKEF for the risks it is assuming
- does not expose the taxpayer to the risk of excessive loss

They apply to business supported since 1991, including direct loans.[14]

UKEF's credit risk is limited by 2 financial measures:

a) **maximum commitment:** a cap on the maximum amount of nominal credit risk exposure that the department may incur – the cap is £50 billion (adjusted for foreign exchange movements)
b) **risk appetite limit:** a form of *economic capital limit* (see page 72 for an explanation of *economic capital*, the manner in which UKEF applies the concept for the purposes of this limit, and details on how the limit is applied)

Additional financial objectives linked to the consent of HM Treasury relate to the adequacy of UKEF's notional reserves (the reserve index) and of its risk-based pricing (the pricing adequacy index and the premium to risk ratio). The reserve index essentially measures whether UKEF has accumulated, over time, sufficient revenue to cover possible credit losses at the 77.5 percentile point on UKEF's 10-year loss distribution.[15] The pricing adequacy index and the premium to risk ratio are more fully described under 'Pricing policies' on page 78.

The 2015-16 outturn against all our financial objectives is presented on page 34.

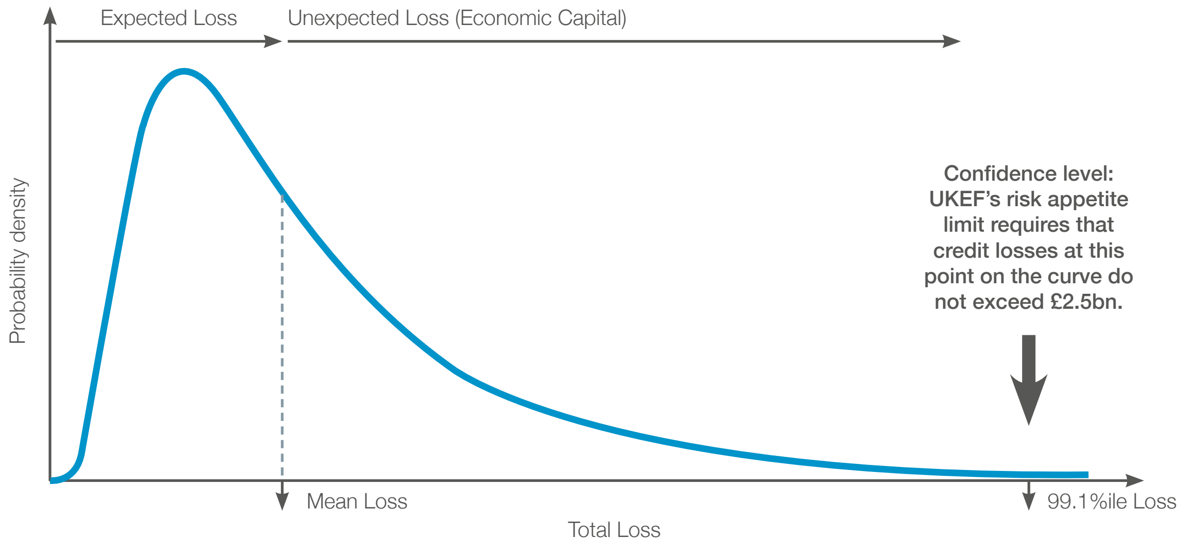
14 Credit exposure incurred prior to April 1991 together with any credit exposure incurred on the instruction of ministers do not form part of these financial objectives. Legacy claims exposure relating to guarantees and insurance issued prior to April 1991 is excluded from this limit. The objective for this exposure is to maximise recoveries and manage assets and liabilities in a way that minimises the net cost to the taxpayer.

15 The reserve index means the ratio of (a) cumulative reserves plus associated provisions to (b) the aggregate of the value of the 77.5 percentile point on UKEF's 10-year loss distribution plus provisions. At the end of each month, the index must be at least 1.

Economic capital and the risk appetite limit

Economic capital (often referred to as capital at risk or CaR) is a measure of risk based on an assessment of future losses. It can be considered as the buffer required to cover unexpected losses over a defined future time horizon at a specified confidence level. The chart below presents this concept graphically for a hypothetical portfolio of credit risks.

Portfolio loss distribution



Expected loss is the anticipated average loss over the relevant time horizon. Expected losses essentially represent a 'cost of doing business'. This implies that, when a financial institution assumes credit risk, it should always look to charge an amount at least sufficient to cover the expected loss associated with the relevant loan or guarantee facility.

The **confidence level** in a private sector context can be viewed as the risk of insolvency during the defined time horizon. The higher the confidence level selected, the lower the probability of insolvency. Through the risk appetite limit, HM Treasury has set a 99.1% confidence level for UKEF over a 10-year time horizon. (This is, of course, a theoretical measure for risk management purposes as, ultimately, if UKEF did incur losses these would be underwritten by public funds.)

Unexpected loss takes account of the potential for actual losses to exceed the expected loss. This simply reflects the uncertainty inherent in the estimate of future losses. Calculations of unexpected loss will tend to increase if a portfolio has high risk concentrations and/or the risks in the portfolio are strongly correlated. UKEF defines unexpected loss as the difference between the portfolio expected loss and the 99.1 percentile value of the loss distribution. (Other financial institutions often consider this to be their **economic capital** requirement.)

The **risk appetite limit** set by HM Treasury means that UKEF must manage its credit risk-taking activities such that total losses, as modelled by our portfolio risk management simulation model, over the coming 10-year time horizon will not (with a 99.1% degree of certainty) exceed **£2.5 billion** (adjusted for foreign exchange movements). In other words, at no time should portfolio expected loss plus provisions against claims already paid plus portfolio unexpected loss exceed £2.5 billion (adjusted for foreign exchange movements):

Portfolio expected loss
+ Provisions
+ Portfolio unexpected loss
≤ £2.5 billion

Risk and exposure management policies

Overarching policies

There are 2 main policies applicable to credit risk management within UKEF. These are the credit risk policy and the pricing methodology. Both policies are reviewed at least annually by the Credit Committee. Our credit risk policy sets out the high-level policies and methodologies we use for assessing, measuring, managing and reporting all categories of credit risk to which UKEF is exposed. It also establishes minimum risk standards and ratings-based exposure caps.[16] A series of more detailed risk management policies, frameworks and individual risk methodologies sit below the credit risk policy.

Our pricing methodology sets the methods and parameters used for setting premium rates for all product types consistent with our policy objective of supporting UK exporter competitiveness while ensuring that we meet our financial objectives and protect the taxpayer from loss. International agreements such as the OECD Arrangement on Officially Supported Export Credits (the OECD Arrangement)[17] and the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures also impose obligations in relation to the adequacy of risk-based pricing.

Exposure management framework

Our role in support of UK exports requires us to assume credit risk in a large number of countries. Individual country limits are established through our exposure management framework, which is based on the following key principles:

- the higher the level of credit risk in a country, the lower the country limit
- the larger a country's economy (as measured by its GDP), the higher the country limit
- country limits should be set relative to the notional financial resources available to UKEF and consistent with UKEF meeting its financial objectives

Country limits and cover policy are reviewed regularly by the Credit Committee. The upper boundary for exposure to any individual country is £2.5 billion. In addition, the Credit Committee sets individual case-level controls within each country limit. The department has to assess risks and decide cover policy in around 200 markets, but priority is given to active new business requirements and existing exposures.

Assessment of country risk

We rank each country where we have actual or potential credit exposure, producing a credit rating using the same letter ratings as the credit rating agency Standard & Poor's (S&P), with AAA being the highest rating and D (default) being the lowest. Our country rating assessments use a similar framework to that employed by S&P, complemented, as appropriate, by information obtained from cross-Whitehall forums, local UK diplomatic representatives, quarterly OECD country risk expert meetings, and country visits. Where no external credit rating exists, we typically derive our final letter rating from a World Bank shadow-rating model supplemented by analyst judgement and peer comparisons.

16 The only time when UKEF's internal risk policies might not apply would be if ministers (having regard to the national interest) gave a written direction to the Accounting Officer requiring a specific credit risk to be underwritten. In these circumstances, the credit risk in question would be handled separately. There is currently no exposure of this kind.

17 The OECD Arrangement, sometimes referred to as "the Consensus", limits self-defeating competition on export credits among members of the OECD. OECD members undertake to operate within these guidelines when providing official support for export credits of two years or more.

Assessment of corporate, bank and project finance risk

Risk assessments for the majority of our medium- to long-term credit exposure to overseas corporates and banks are based on S&P methodologies. We use a number of credit rating templates from S&P covering our principal areas of business (namely general corporates, airlines, banks and project finance). The templates are updated annually and approved by the Credit Committee.

The rapid expansion of our trade finance business has required us to develop a number of bespoke credit assessment methodologies for certain categories of risk. Typically, this type of business is in support of exports by smaller and mid-sized UK companies and involves relatively small individual credit risk exposures. In relation to 2 products (the bond support scheme and the export working capital scheme), UKEF assumes direct credit exposure on the UK exporters. To meet the shorter turnaround times for this type of business, we have developed a streamlined credit assessment methodology tailored for smaller companies. Similarly, we have devised bespoke credit assessment processes to handle the payment risks arising under our export insurance and the credit and political risks covered by our bond insurance.

UKEF's products and related credit risk methodologies

Product category	Product	Summary description	Credit risk party	Credit risk methodology
Credit insurance	Export insurance policy (EXIP)	Covers non-payment risk under an export contract (commercial & political risks)	Overseas buyer	UKEF bespoke methodology
	Bond insurance policy	Covers unfair calling of contract bonds	Overseas buyer	UKEF bespoke methodology
Loan/capital market guarantees	Buyer credit	Guarantees lenders or capital market investors providing medium / long term finance to overseas buyers of UK goods / services	Overseas buyer	UKEF bespoke country risk methodology / S&P rating methodologies
	Supplier credit			
	Lines of credit			
	Export refinancing facility	Add-on to buyer credit securing availability of long term funding	Overseas buyer	
Trade finance	Bond support scheme	Guarantees in support of contract bonds	UK exporter	UKEF bespoke methodology
	Export working capital scheme	Guarantees lenders providing working capital finance to UK exporters	UK exporter	UKEF bespoke methodology
	Letter of credit guarantee scheme	Guarantees banks which confirm letters of credit issued in favour of UK exporters	Overseas issuing bank	S&P bank rating methodology
Lending	Direct lending facility	Medium / long term loans made to overseas buyers of UK goods / services	Overseas buyer	UKEF bespoke country risk methodology / S&P rating methodologies
Investment insurance	Overseas investment insurance	Insures overseas assets of UK exporters against various political risks	Overseas buyer and its sovereign	UKEF bespoke methodology

UKEF continues to have residual credit exposure to a small number of 'investment grade' banks that act as counterparties in interest rate swaps entered into by the department to hedge interest rate exposure under its legacy fixed-rate export financing scheme, which was closed to new business in 2011 (see page 89). External credit ratings are applied to these counterparties and various ratings-based credit triggers are included in the swap documentation, giving UKEF the right to terminate the trades in the event of a counterparty's credit rating falling below specified thresholds.

Outputs from our credit risk assessments

All credit risks within UKEF are assigned a letter rating from AAA to D and each letter rating has an associated probability of default (PoD). The PoDs are updated at least annually based on the latest S&P default statistics. The second output from UKEF's credit assessments is an estimate of loss given default (LGD), ie how much we might lose in the event of an obligor defaulting on its obligations. This is expressed as a percentage. Corporate LGD assessments are typically made on a case-by-case basis taking into account a variety of factors specific to the transaction in question such as security, priority ranking, and the likelihood of restructuring, sale or liquidation. In the absence of a bespoke calculation, UKEF's standard corporate LGD assumption is 50% (compared with 45% under the Basel Accords' internal ratings-based approach). In the case of sovereign risk, an additional factor is included in our assessment of potential loss: persistence of default, which seeks to assess the duration of a country's default. The persistence of default varies by country, with empirical research suggesting that the length of a country's default is primarily a function of its per capita income, the severity of its indebtedness and whether the default is a liquidity event or an insolvency.

PoDs and LGDs are 2 of the 3 components of expected loss. The third is exposure at default, ie how much credit risk exposure we have at the time of default. Expected loss is a key measure of credit risk at UKEF and is central to our pricing methodologies and our underwriting fund accounting.[18]

The other important measure of credit risk, which we monitor closely as it is integral to our credit risk appetite, is unexpected loss. Unexpected loss is a portfolio-level concept derived from UKEF's credit portfolio loss distribution. As explained in the chart 'Economic capital and the risk appetite limit' on page 72, we define unexpected loss as the difference between the 99.1 percentile value of the loss distribution and the portfolio expected loss. Unexpected loss will typically increase if a credit portfolio has high risk concentrations and/or if the risks themselves are highly correlated. The nature of UKEF's business means that, compared with the more diversified credit portfolios of private sector financial institutions, risk concentrations and correlations are key considerations for the department.

Probability of default X **Loss given default** X **Exposure at default** = **Expected loss**

18 Expected loss applies both at an individual transaction level and at portfolio level. At a portfolio level, it is simply the sum of the expected losses of all risks in the portfolio and equates to the mean of the portfolio loss distribution.

Risk concentrations and correlations

Given its role, it is almost inevitable that UKEF's credit portfolio will have risk concentrations. Consequently, portfolio modelling (and especially the impact on portfolio unexpected loss) plays an important role in deciding the maximum amount of credit exposure UKEF might assume on a single obligor or on a group of related obligors. In determining the potential impact on portfolio unexpected loss for any given case, our modelling will seek to take into account the likely correlations between all the various risks in the portfolio. Only if the Credit Committee is satisfied (on the basis of extensive portfolio modelling) that a given level of credit exposure will not threaten any of the department's financial objectives will it consider making a positive recommendation to the Chief Executive. Portfolio modelling is only one of a number of measures in place to manage risk concentrations. All individual exposures within a country must fall within the relevant country limit as established under our exposure management framework and no single commitment in excess of £200 million may be given by UKEF without the agreement of HM Treasury.

One practical means of reducing risk concentrations at transaction initiation stage is through reinsurance or counter-guarantees from the market or, more normally, other export credit agencies. UKEF will often seek this when it is acting as lead export credit agency in a transaction where goods/services are sourced both from the UK and from other countries. The most frequent example of this occurs with support for Airbus aircraft. When UKEF is in the lead on an Airbus transaction, it will typically obtain counter-guarantees from its French and German counterparts in proportion to their respective work shares (see page 60 for 2015-16 commentary).

Stress testing and scenario analysis

It is UKEF policy to undertake extensive stress testing of its credit portfolio and we assess the impact of a number of adverse scenarios every 6 months. Stress testing typically involves simulating rating downgrades, increases in LGDs and a series of large individual defaults. The adverse scenarios are designed to reflect possible emerging risks and may vary from one exercise to the next. Scenarios recently considered include a general emerging markets crisis and an extended period of very low oil prices. The results of the stress tests and scenario analysis are reviewed by the Credit Committee. One of the key issues it considers is the impact that each of the stress tests and scenarios has on the value of the 99.1 percentile point on the portfolio loss distribution relative to the risk appetite limit of £2.5 billion. UKEF uses its own portfolio risk management simulation model, with its associated correlation matrices, to undertake all forms of portfolio-level credit risk modelling and to produce portfolio loss distribution curves. The model is also used to simulate the extent and timing of potential gross cash outflows as a result of claims payments or defaults on direct loans. This provides valuable information, for us and for HM Treasury, for cash flow forecast and liquidity management purposes.

Pricing policies

Context

On the principle of a 'level playing field', the OECD Arrangement requires participating export credit agencies such as UKEF to charge risk-based premium rates sufficient to cover their long-term operating costs and credit losses. This requirement echoes the provisions of the WTO Agreement on Subsidies and Countervailing Measures, which classifies as a 'prohibited subsidy' export credit guarantee programmes that don't cover their long-term operating costs and losses.

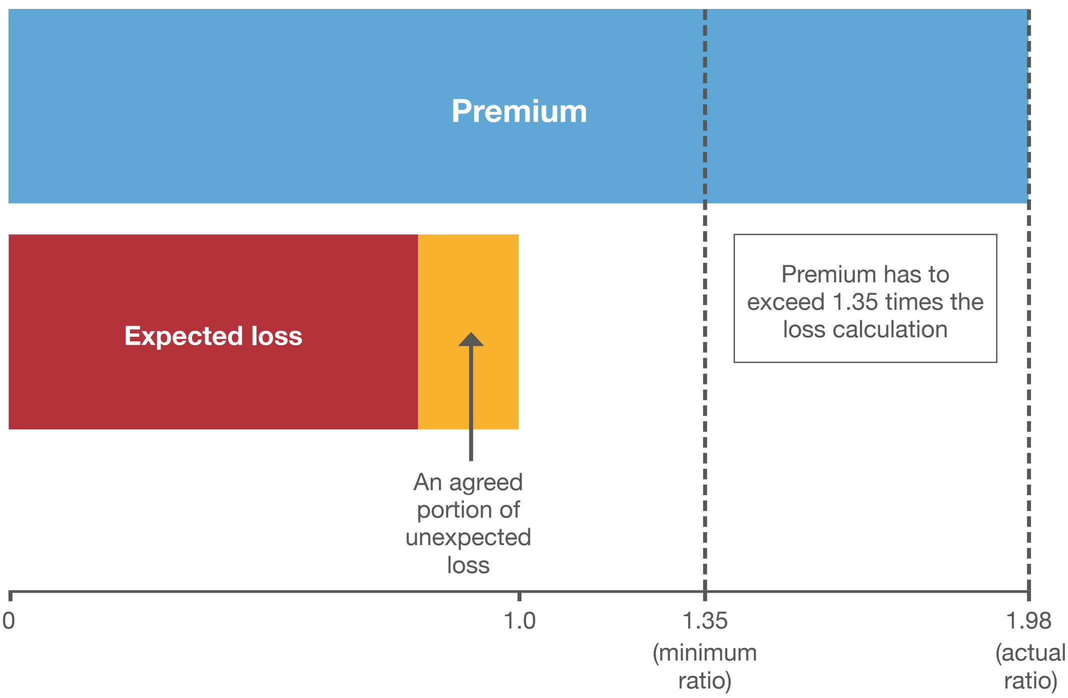
Financial objectives

Consistent with these principles, HM Treasury has set 2 financial objectives for UKEF designed to ensure, as far as possible, that that the premium rates we charge reflect the risk taken on, and are sufficient to enable the department to operate at no net cost to the taxpayer. These financial objectives are the **premium to risk ratio** and the **pricing adequacy index**.

The premium to risk ratio requires us to demonstrate each month that the premium charged on the business in the financial year will be 1.35 times an agreed level of possible losses.

The ratio at 31 March 2016 was 1.98 against the 1.35 minimum:

Premium to risk ratio

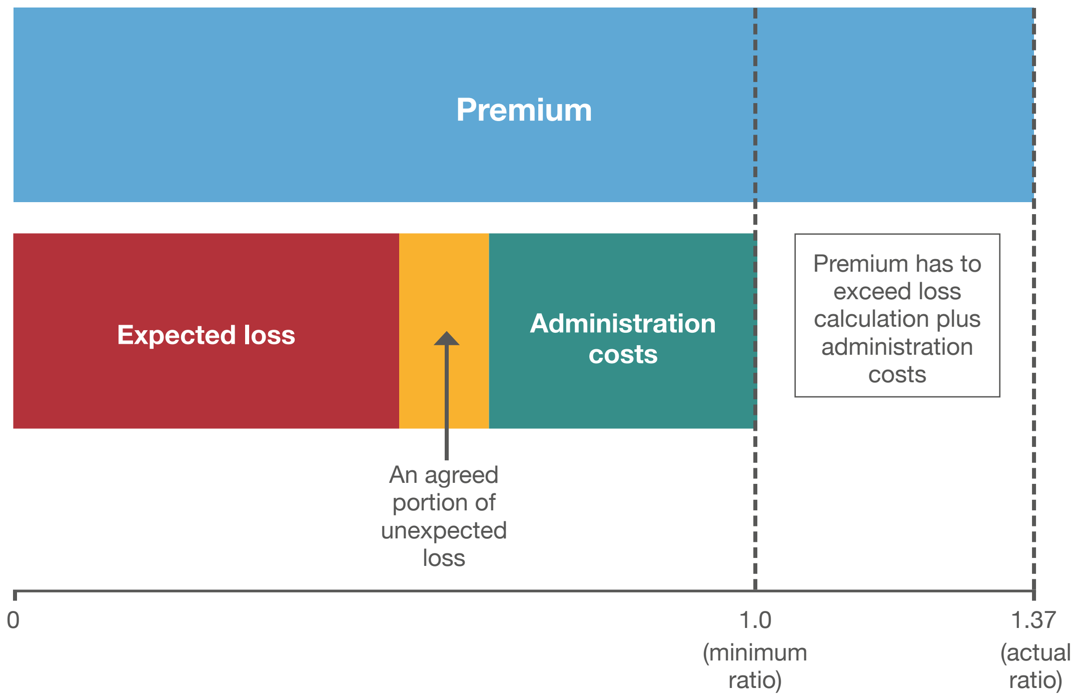


The pricing adequacy index is a 3-year measure applied to 3 accounting periods:

(i) past 2 years and present financial year
(ii) previous, present and next year
(iii) present year and next 2 years

Whereas the premium to risk ratio is purely an annual measure, the pricing adequacy index takes into account issued business, forecast business and administrative costs over these 3 periods. For each period UKEF is required to demonstrate that the actual/ forecast premium will more than cover the administration costs and an agreed level of possible losses. The ratio for the past 2 years and present financial year was 1.37 against the minimum of 1.0:

Pricing adequacy index



Forecasts are based on the judgements of our underwriters who draw on available transaction pipeline information, market intelligence, and the estimated likelihood of transactions materialising within the financial year. We perform regular sensitivity analysis to supplement ‘central’ forecasts and to test the robustness of forecast financial performance against the agreed targets for premium to risk ratio and the pricing adequacy index.

Pricing methodology
Our pricing methodologies and parameters are reviewed annually by the Credit Committee and agreed by HM Treasury. They are used to set risk-based premium rates for all of our products.

It is our policy to support UK exporter competitiveness by setting the lowest premium rates achievable subject to the following:

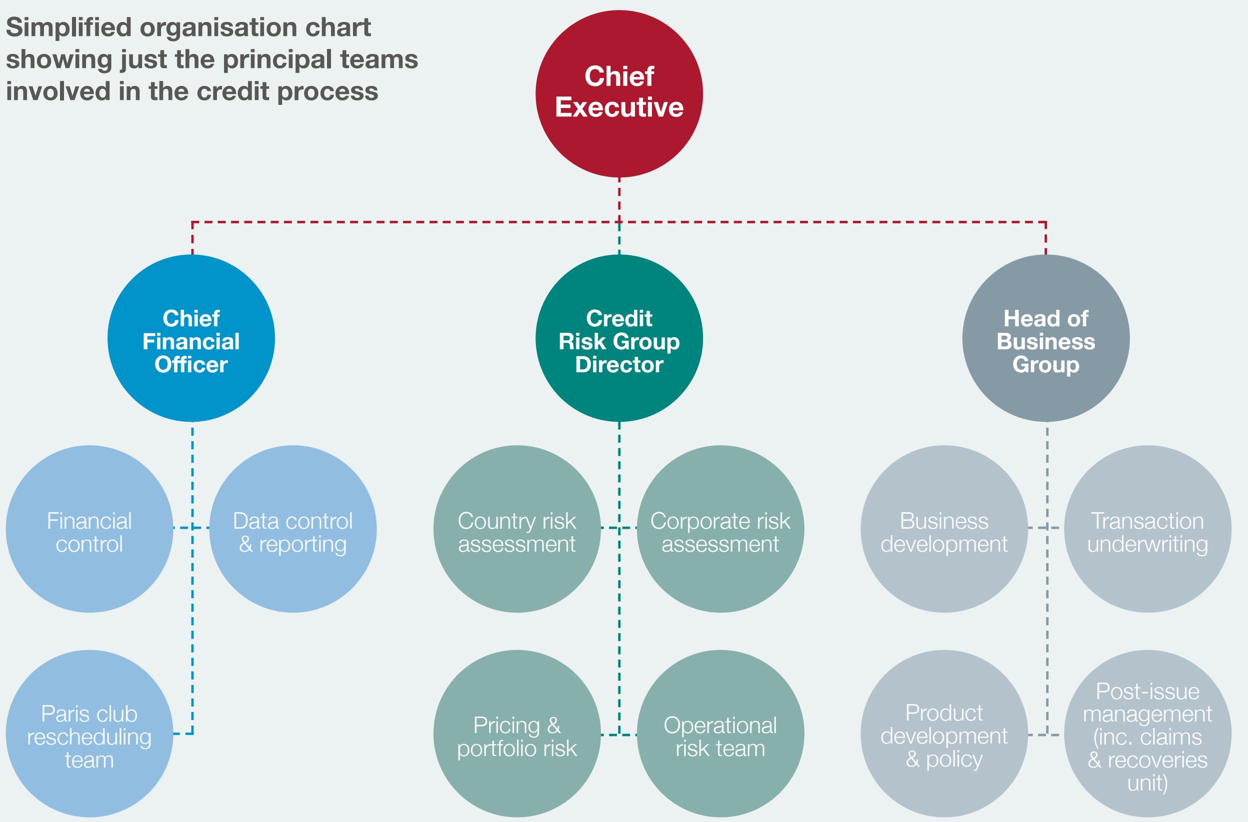
- Premium rates may not be set that undercut the minimum rates set out in the OECD Arrangement.
- No individual premium can be set below the expected loss associated with that transaction.
- Aggregate premiums must be sufficient to meet the target premium to risk ratio and pricing adequacy index financial objectives.
- In OECD market benchmarking countries (rich markets), we seek to ensure that our premium rates do not undercut available market pricing.
- All premium rates must be set in order to ensure compliance with our international obligations generally, including under EU state aid legislation.

In practice, the vast majority of medium- and long-term transactions are priced at the minimum rate permitted under the OECD Arrangement.

Organisational model and accountabilities

UKEF has a functional organisation structure, with the business origination teams separated from the risk, financial control and reporting functions. This basic internal control is designed to avoid conflicts of interest and to provide appropriate checks and balances in the credit approval and credit management processes.

Simplified organisation chart showing just the principal teams involved in the credit process



A framework of delegated credit authorities exists within the Credit Risk Group. The Chief Executive has granted authority to the Credit Risk Group Director to approve various categories of credit risk within pre-determined limits. In turn the Credit Risk Group Director has granted certain credit approval authorities to senior staff within his team. Any credit approvals that exceed the delegated authority of the Credit Risk Group Director must be approved by the Credit Committee.

Credit processes and reporting

All material credit risks are approved by the Credit Committee or by a designated member of the Credit Risk Group acting under an appropriate delegated credit authority. Once approved, credit exposures are subject to ongoing monitoring and review both at a portfolio and individual transaction level.

Portfolio-level monitoring by the Credit Committee includes biannual stress testing and scenario analysis as well as monthly reviews of portfolio movements, with a particular focus on changes to exposure, expected loss and unexpected loss. Monthly management information records the performance of the credit portfolio against our financial objectives. We also monitor monthly exposure within the agreed country and other limits.

At a transactional level, we produce regular rating updates on countries and individual obligors and, where applicable, confirm compliance with financial covenants contained in loan agreements upon receipt of relevant audited accounts. UKEF maintains 'watch lists' of obligors whose credit risk is deteriorating. If the credit deterioration of a non-sovereign borrower is such that the department might expect to pay a claim under a guarantee or insurance policy, management of the case will move to a dedicated claims and recoveries unit.

The Claims and Recoveries Unit submits regular reports to the Credit Committee on all accounts under its responsibility and seeks its approval for recovery actions. Once a claim has been paid, the Claims and Recoveries Unit will make case-by-case provisioning recommendations to the Credit Committee, with a full provisioning exercise being conducted at the end of each financial year.

Sovereign defaults that lead to debt renegotiations through the Paris Club[19] are managed by a team within the Finance Group, specialising in Paris Club reschedulings and working in conjunction with HM Treasury. Paris Club developments are monitored by the Credit Committee, which will approve any provisions to be made against this exposure. Recovery through Paris Club reschedulings can often be a protracted process - a number of active Paris Club reschedulings relate to exposure incurred prior to April 1991.

19 The Paris Club is the informal group of official creditors that seeks to establish coordinated and sustainable solutions to debt service difficulties experienced by debtor countries.

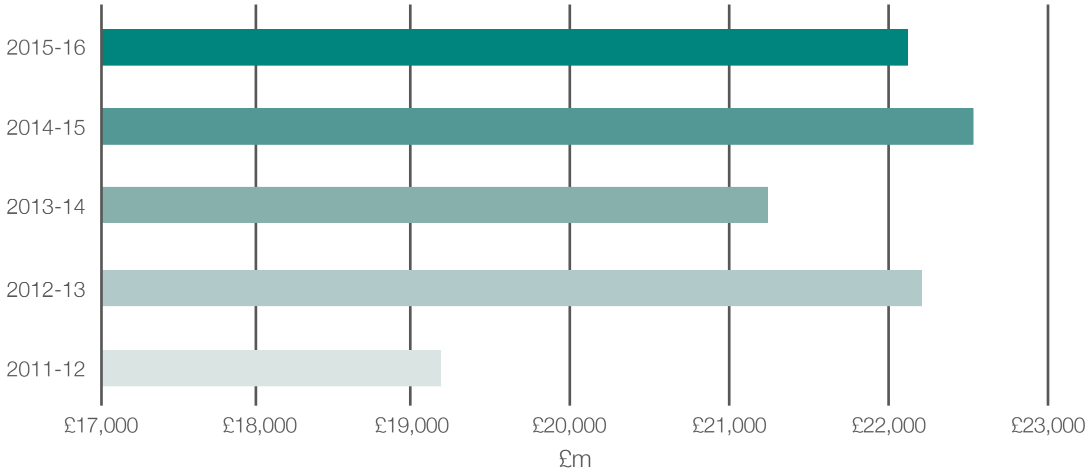
Credit risk performance 2015-16

Context

Consistent with our role as the UK's official export credit agency, our credit portfolio is dominated by long-dated emerging market risk. We have limited ability to influence the geographical or sectoral composition of our portfolio, as we assume credit exposure in in support of UK exporter success at any given time, rather than through a deliberate management choice to build a well-balanced portfolio. Consequently, it is natural for our credit portfolio, like those of other export credit agencies, to have higher risk concentrations than typically seen in private sector financial institutions. Our financial objectives, set by HM Treasury for UKEF, take account of these factors.

During 2015-16 we were able, once again, to comply fully with all the financial objectives applicable to our credit portfolio. Outturn on all our financial objectives is reported on page 34.

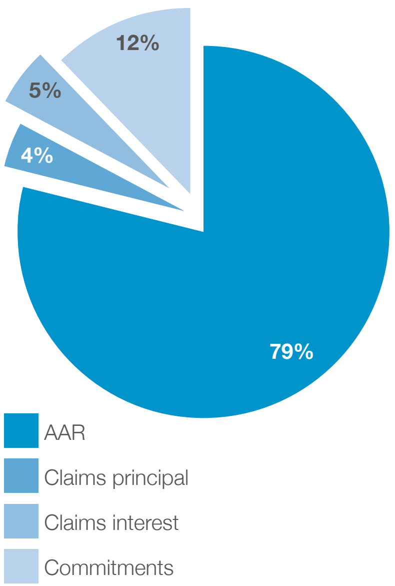
Gross credit risk exposure (£m)



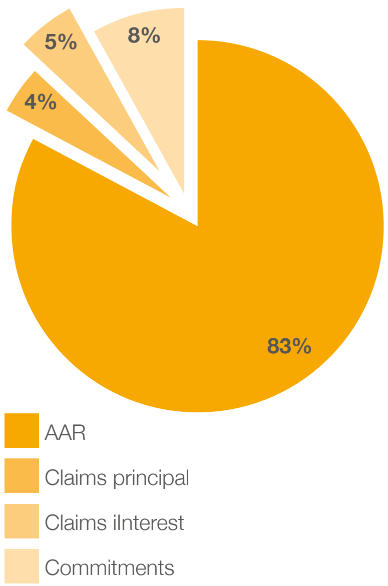
Total credit risk exposure on all business reduced slightly over the past 12 months from £22.5 billion (31 March 2015) to £22.1 billion (31 March 2016) as portfolio run-off, including pre-payments and recoveries, exceeded new business levels.

The charts below show the breakdown of this exposure between amount at risk (AAR)[20], claims (both principal and interest) and commitments[21].

Breakdown of total exposure
31 March 2016

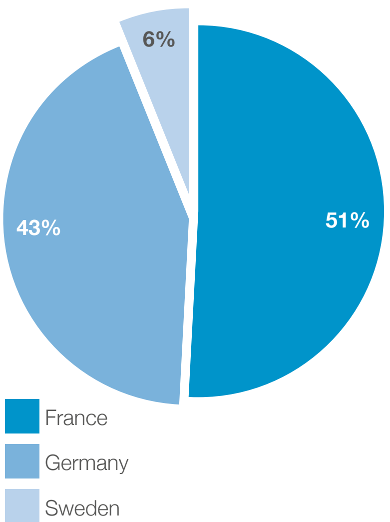


Breakdown of total exposure
31 March 2015

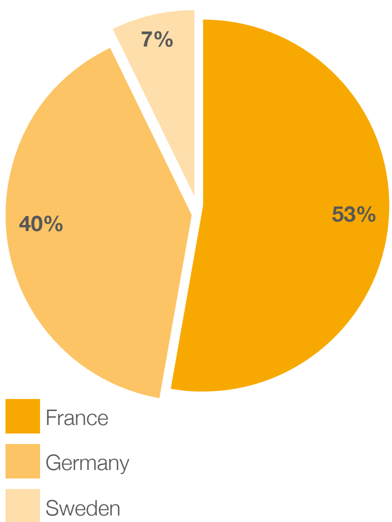


At 31 March 2016, total AAR amounted to £17.5 billion (£18.7 billion for 2015). This figure includes £5.5 billion (£5.3 billion for 2015) of counter-guarantees provided to UKEF by other European export credit agencies principally related to Airbus-supported business.
A breakdown of the export credit agency counter-guarantees is given in the charts below.

Breakdown of export credit agency counter-guarantees
31 March 2016



Breakdown of export credit agency counter-guarantees
31 March 2015



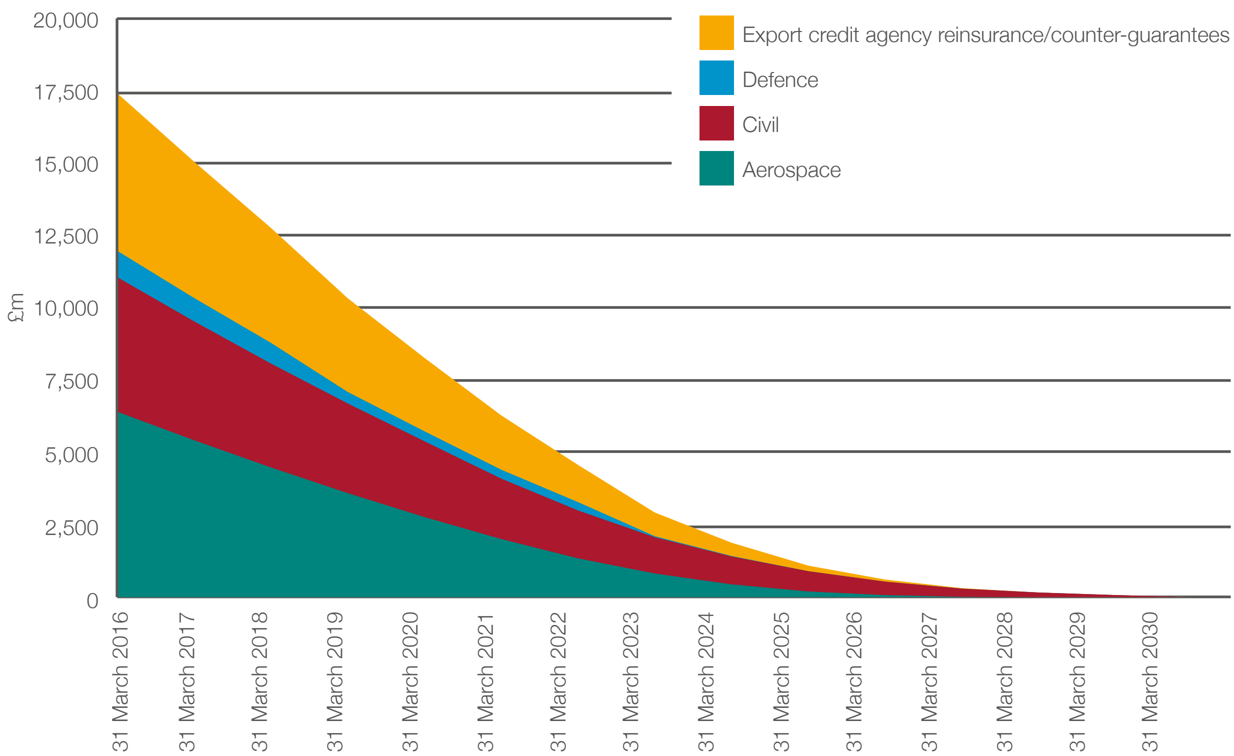
20 AAR is equivalent to the accounting term Contingent Liability. This represents the unexpired portion of the total risks guaranteed by UKEF; thus AAR would normally be less than Maximum Liability by the amount of expired risk, i.e. payment received or the unutilised amount of a loan.

21 Commitments are cases not yet the subject of an issued guarantee, but for which UKEF has communicated its willingness, before a specified date and subject to conditions, to provide support.

Horizon of risk

Despite the recent introduction of trade finance products, the vast majority of our credit exposure extends into the medium and long term. The chart below illustrates how the current portfolio runs off over time in terms of overall AAR. Over the next 12 months, around 14% will run off and after 4 years around 50% of the current portfolio will have expired.

Amount at risk run-off (£m)



Exposure by product

The table below shows a breakdown of the AAR by product sector (excluding export credit agency reinsurance/counter-guarantees). The most notable changes over the past 12 months have related to corporate credit and bond insurance policy exposure. The increase in corporate credit, from 13% to almost 20%, is principally due to new business undertaken in the construction and energy sectors. The decrease in bond insurance exposure is due to the early expiry of a single large policy.

Breakdown of AAR, by product sector (£m) – excluding export credit agency reinsurance/counter-guarantees

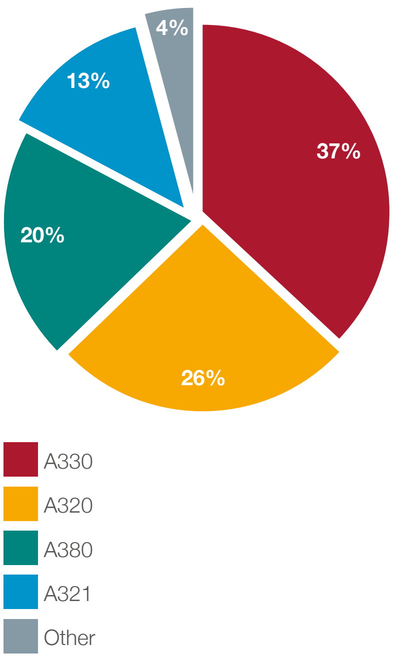
Product sector	31 March 2016		31 March 2015	
Civil aerospace	6,346	52.9%	6,935	51.6%
Sovereign credit	888	7.4%	1,048	7.8%
Corporate credit	2,347	19.6%	1,773	13.2%
Project finance	1,113	9.3%	1,127	8.4%
Bank	195	1.6%	265	2.0%
Export insurance	522	4.3%	531	4.0%
Bond insurance	41	0.3%	1,041	7.7%
Bond support	177	1.6%	655	4.9%
Direct lending	339	2.8%	45	0.3%
Other	26	0.2%	15	0.1%
Total	11,994	100.0%	13,435	100.0%

Risk concentrations

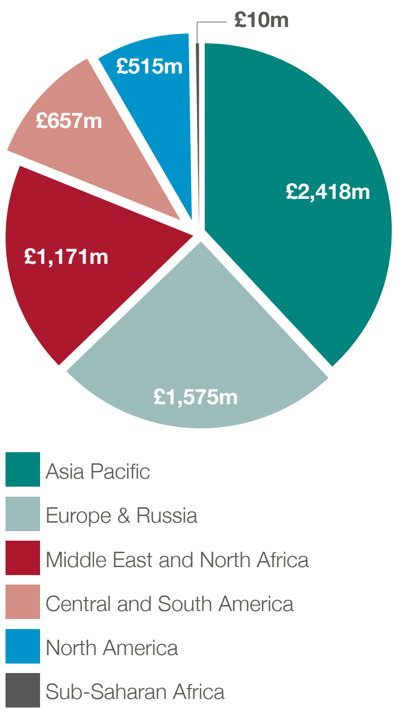
Sectors

Exposure to the civil aerospace sector remains UKEF's largest risk concentration, accounting for 53% of the AAR (net of export credit agency reinsurance/counter-guarantees) as at 31 March 2016 (52% for 2015). However, the aerospace portfolio is well diversified across airlines and aircraft leasing companies, by aircraft type and by geographical region. The charts below show a breakdown of the portfolio, by aircraft type and geography.

Aerospace portfolio by aircraft type



Aerospace portfolio by geography



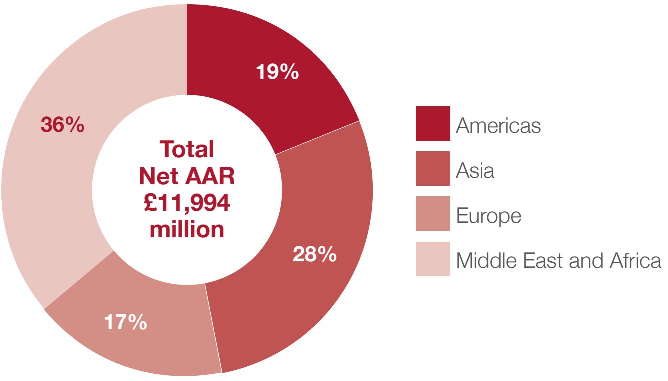
All aerospace exposure is secured on the underlying aircraft.[22] After allowing for the value of this asset security, UKEF's net exposure to the sector was much lower at £306 million (£586 million for 2015).

As at 31 March 2016, UKEF had £1.1 billion (AAR) of exposure to the oil and gas sector, representing 9% of overall AAR (net of export credit agency reinsurance/counter-guarantees). This exposure was mainly to major emerging market oil companies in South America, Eastern Europe and Asia. Other sectoral concentrations were to the chemicals industry, with £1.1 billion AAR spread across the Middle East and Asia and to the commercial real estate sector (£1.5 billion AAR) mainly in the Middle East.

Geography

As at 31 March 2016, the Middle East and Africa region accounted for 36% of portfolio AAR (net of export credit agency reinsurance/counter-guarantees). The majority of this exposure was a result of support for UK exports to Dubai, Saudi Arabia, Oman and Abu Dhabi. Asia accounted for 28% of net AAR, with around 75% of Asian exposure being attributable to civil aerospace business spread across a number of airlines. In the Americas, around 50% of exposure was attributable to the aerospace sector while much of the non-aerospace exposure was centred on Brazil.

Regional breakdown of net AAR - whole portfolio



AAR at 31 March 2016: darker shading indicates higher AAR.

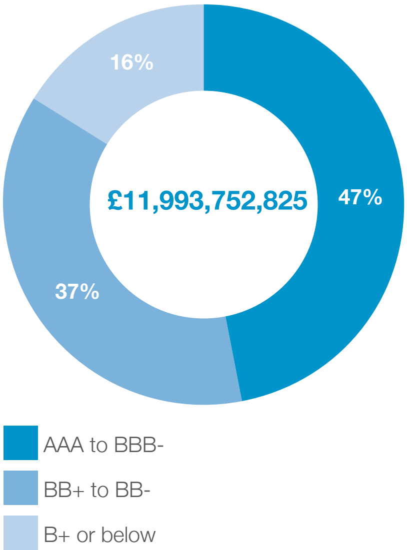
22 This means that UKEF can take possession of aircraft from defaulting airlines. Following the 9/11 terrorist attacks in the US we took possession of, leased and eventually sold 44 aircraft, ensuring losses both to the airline industry and UK taxpayer were minimised during this difficult period.

Credit quality

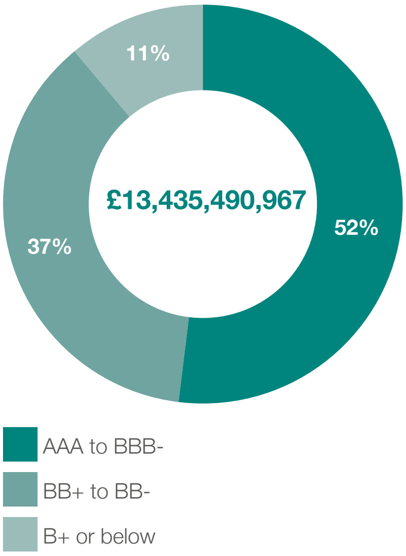
The credit risk in our overall portfolio increased slightly during 2015-16. This is shown by a decrease in the proportion of the portfolio rated as 'investment grade' (ie having a rating of BBB- or better) as well as increases in both expected loss and unexpected loss.

As at 31 March 2016, 47% of AAR (net of export credit agency reinsurance/counter-guarantees) was rated 'investment grade' by UKEF compared with 55% for 2015. The principal reason for this change was the expiry, during the year, of more than £1.5 billion of 'investment grade' exposure associated with a single case.

Net AAR by ratings
31 March 2016



Net AAR by ratings
31 March 2015

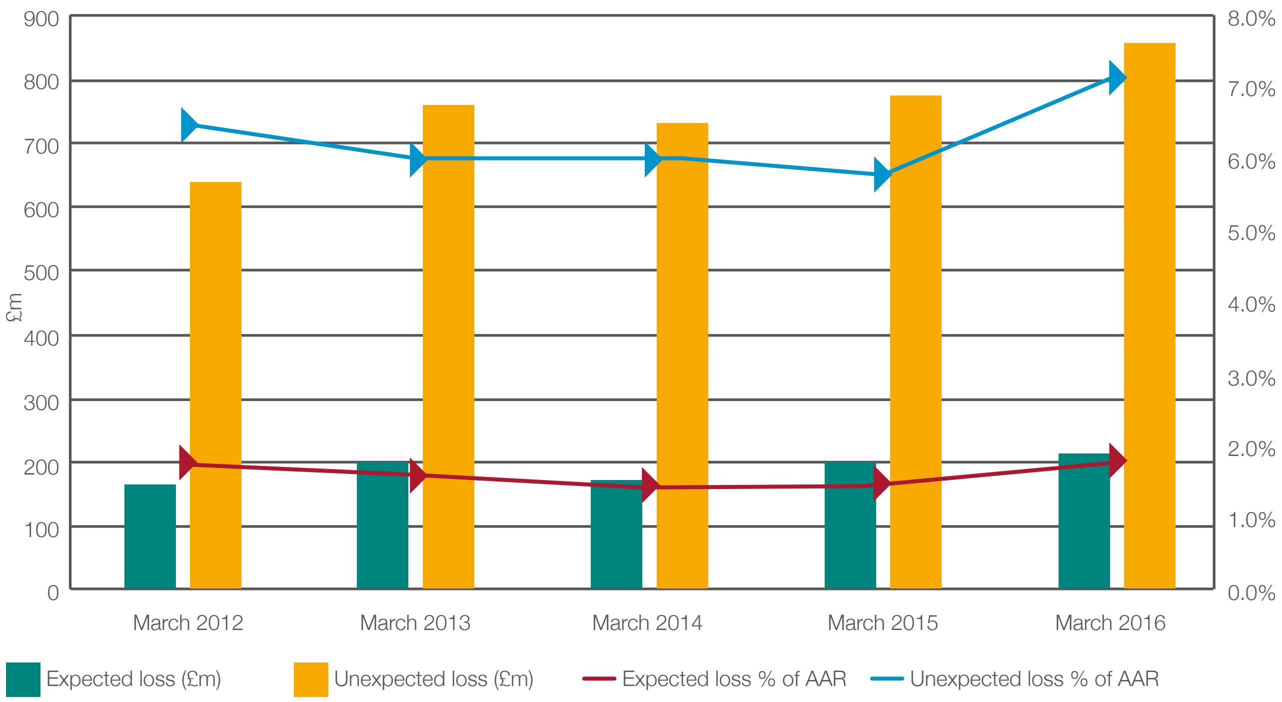


More than 80 individual rating changes were made during the course of the year as part of the ongoing monitoring and management of the portfolio. Downgrades exceeded upgrades by a ratio of approximately 2:1, reflecting some of the stresses which affected a number of emerging markets over the past 12 months.

In line with the ratings changes mentioned above, portfolio expected loss (EL) increased slightly to £211 million from £198 million in 2015. It now represents 1.8% of AAR (net of export credit agency reinsurance/counter-guarantees) compared with 1.5% for 2015.

Unexpected loss (UEL) also increased to £856 million as at 31 March 2016 (£776 million for 2015). It now represents 7.1% of AAR (5.8% for 2015), net of export credit agency reinsurance/counter-guarantees. The chart below shows the trend of both these key risk measures over the past 5 years.

Portfolio expected loss and unexpected loss trend (all losses contingent, not realised)



Recoverable claims

The slight increase in the credit risk profile of the portfolio referred to above was not, however, reflected in any increase in claims paid during the year. In 2015-16 we paid claims totalling £5.4 million (£6.4 million for 2014-15). Of this amount, £3.8 million represented claims payments made in respect of new defaults. The balance was paid out under guarantees or insurance policies during 2015-16 but was attributable to defaults that had occurred in earlier years. The new claims were in respect of defaults by buyers in Russia, Libya and Turkey.

Overall recoveries (on all business, principal and interest) made during the year amounted to £160 million (£141 million for 2014-15), reducing total recoverable claims (excluding interest on unrecovered claims) to £876 million (£996 million in 2014-15). The majority of the recoveries (£141 million) were made through the Paris Club and related to historical sovereign debt reschedulings. Recoveries from a number of corporate names made up the balance.

Provisions

As at 31 March 2016, total provisions against all gross recoverable claims and interest on unrecovered claims increased marginally to £1.43 billion from £1.42 billion in 2015. The adequacy of provision levels was fully reviewed at the end of the year with existing provisions currently covering 72% of total recoverable claims and interest (68% in 2015).

Risk appetite limit

Given the increases in expected loss, unexpected loss, and provisions for all business issued since 1991, the 99.1 percentile point of the department's portfolio loss distribution inevitably rose during 2015-16. At the year end, it stood at £1.3 billion (£1.2 billion for 2015), still comfortably within the limit of £2.5 billion set by HM Treasury.

Portfolio stress testing

The portfolio of business issued since 1991 is subject to regular stress testing and scenario analysis. The table below shows the portfolio's sensitivity to changes in ratings and recovery rates.

Portfolio stress tests[23]

(£m)	Across the board ratings downgrade	Reduced recovery rates	Ratings downgrade and reduced recovery rates
	2 notches	- 20%	2 notches & -20%
Increase in expected loss	198	67	326
Increase in 99.1 percentile point	374	224	812

None of the movements in the 99.1 percentile point shown above would cause our risk appetite limit to be breached.

Other financial objectives

In addition to complying with our risk appetite limit, we met all other credit-related financial objectives set for us by HM Treasury during 2015-16 as reported on page 34.

Market risk management

Context

Market risk is the risk of losses arising from movements in market prices. For UKEF, this risk arises with changing interest rates and changing foreign exchange rates. UKEF's principal exposure to interest rate movements is through its legacy fixed-rate export finance scheme, which was closed to new business in 2011. Foreign currency risk arises from 2 main areas: transaction risk and translation risk. Transaction risk for UKEF is the risk of movements in the sterling value of foreign currency interest receipts on conversion into sterling. Translation risk is the risk that UKEF's statement of financial position and net operating income will be adversely affected by changes in the sterling value of assets denominated in foreign currency and by liabilities from movements in foreign currency exchange rates.

Interest rate risk

Fixed rate export finance scheme

Up to 2011, UKEF operated a fixed rate export finance scheme, under which it supported medium- and long-term fixed-rate lending by commercial banks at internationally agreed 'commercial interest reference rates' (CIRRs) to overseas borrowers. The lending banks funded the loans at floating rates (LIBOR plus a margin). Through 'interest make-up' arrangements, UKEF made up the difference when the lender's floating rate was more than the applicable CIRR. When the floating rate was less than the applicable CIRR, the lender paid UKEF the difference. This system exposed UKEF to interest rate risk. Prior to the closure of the scheme in 2011, UKEF had pursued an active interest rate hedging policy, eliminating, as far as possible, its exposure to interest rate risk via a portfolio of matching interest rate swaps. These interest rate swaps remain in place, reducing in line with the amortising profile of the loans themselves.

HM Treasury no longer applies a quantitative financial objective to this legacy portfolio. Also, given the substantially matched position of the interest make-up arrangements and the interest rate swaps, no new hedging activity has been undertaken since 2011 nor is planned for the future. Accordingly, internal policies in relation to active hedging have been discontinued. Nevertheless, we monitor the financial position of the scheme and its residual interest rate risk closely. The portfolio is valued on a daily basis with its profit and loss performance measured against a series of internal limits. Movements in excess of these limits are immediately reported to the Chief Financial Officer and the Credit Committee for action as appropriate. These arrangements,

23 This stress test is based on the complete UKEF portfolio. The corresponding sensitivity analysis presented on page 192 in note 21 of the accounts is based on a portfolio containing only insurance contracts, as defined by our accounting policies.

together with a variety of other reporting provisions applicable to the scheme, are approved annually by the Credit Committee. Periodic sensitivity analysis is carried out on the portfolio to gauge the financial impact on UKEF of interest rate movements.

Direct lending

In 2014, UKEF introduced a direct lending facility, which provides loans to buyers of UK goods and services at CIRR. UKEF is not charged interest by HM Treasury on the funding provided to it for making these fixed-rate direct loans. Consequently, movements in interest rates during the life of the loans do not affect the financial performance of our direct lending activities. To ensure that interest earned on each CIRR-based direct loan adequately covers the government's borrowing costs, a check is made prior to commitment to confirm that the sterling CIRR applicable to the direct loan is higher than the corresponding National Loans Fund rate. If this is not the case, then interest on the direct loan will be charged at the higher rate. A similar arrangement, involving an interest rate check based on cross-currency swap methodologies, applies where direct loans are denominated in eligible foreign currencies.

Foreign currency risk

Translation risk

A material proportion of our guarantees and insurance policies are written in foreign currencies (mainly the US dollar), thereby exposing us to foreign currency risk and associated volatility in our financial results. The most significant year-on-year fluctuations in financial performance (evidenced by net foreign exchange gains/losses in the statement of CNI) stem from the currency movements applicable to our non-sterling insurance assets (recoverable claims). HM Treasury does not permit UKEF to manage its foreign currency exposures and so no active hedging is undertaken. This is based on a number of HM Treasury considerations, including the fact that our foreign currency assets and liabilities generally have long tenors such that the transaction risks can be a long time into the future, and the timing and size of the amounts needing to be converted are uncertain, which could well make for expensive hedging arrangements. In addition, our balance sheet provides some natural hedging of translation risk, and foreign exchange hedging is not straightforward and would require some specialist skills to operate it, adding to our operating costs.

Currency movements also have an impact on the sterling value of our contingent liabilities (principally guarantees and insurance policies). These movements can cause significant fluctuations in the sterling value of the department's AAR and, consequently, overall credit risk exposure. Since our maximum commitment and risk appetite limit (as financial objectives set by HM Treasury) are adjusted for movements in US dollar/sterling exchange rates, we are afforded a degree of protection from adverse currency movements in meeting these 2 key financial objectives.

Direct lending

Direct lending in currencies other than sterling is likely to increase foreign currency risk for UKEF. The lack of permission for UKEF to undertake foreign currency hedging applies equally to the department's direct lending activities. Consequently, changes in the sterling value of these direct loans as a result of foreign exchange rate movements will be reflected in the financial performance of our direct lending business.

Market risk performance

Interest rate risk

The legacy fixed rate export finance portfolio continued to amortise during 2015-16, thereby reducing further UKEF's exposure to interest rate risk. Note 21 to the accounts includes details of the remaining maturity profile of the portfolio and the portfolio's sensitivity to movements in interest rates (see page 180).

Foreign currency risk

As UKEF does not hedge its interest rate risk, our financial results will inevitably be affected by changes in the value of sterling relative to those currencies in which we transact business. During 2015-16 UKEF realised a net foreign exchange gain of £13 million (£34 million for 2014-15), principally as a result of changes in the value of its foreign currency denominated recoverable claims. A significant proportion of these claims are denominated in US dollars and, during the year, sterling depreciated by approximately 3% against the US dollar. Note 21 of the accounts includes details of the currency profile of our insurance assets, financial instruments and capital loan commitment (see page 181).

Liquidity risk management

Liquidity risk is the risk that a business, though solvent, either does not have the financial resources to meet its obligations as they fall due, or can secure those resources only at excessive cost. As a government department, UKEF has access to the funds required to meet its obligations as they fall due, drawing on the Exchequer as required.

The nature of some of UKEF's products means that significant payments could be required within a few days in the event of a default by an insured or guaranteed party. Arrangements to cover this eventuality have been pre-agreed with HM Treasury. As regards UKEF's direct lending activities, the requisite funding is provided by HM Treasury.

Note 21 of the accounts shows the scheduled maturity profile of UKEF's insurance contracts, expressed in terms of total AAR, and the dates at which the periods of risk expire (see page 191).

Our exposure to foreign exchange movements has the potential to impact our ability to remain within the resources allocated to us by Parliament. Our voted control totals include headroom to mitigate this risk. However, from the last opportunity to adjust voted control totals in January to 31 March there is a small risk that exchange rates could move and reduce our net income by more than the headroom we had agreed with HM Treasury and voted by Parliament. This would result in a breach of expenditure limits and require a vote to approve the excess.

Any cash surplus generated by UKEF is paid back into public funds.

Financial performance

UKEF achieved an operating surplus for the year ended 31 March 2016 of £106 million compared with £129 million for the year to 31 March 2015. The decrease in net operating income for the year was largely as a result of:

- a decrease in the release from the underwriting funds closed in the current year to £36 million in 2015-16 from £52 million in 2014-15[24]
- a lower foreign exchange gain of £13 million for 2015-16 compared with a gain of £34 million in 2014-15

Accounts 1 to 5

UKEF operates 5 accounts: Accounts 1, 2 and 3 cover underwriting activities, while Accounts 4 and 5 cover activities in relation to direct lending or the administration of refinanced loans.

- Account 1 relates to guarantees and insurance issued for business prior to April 1991 and to insurance issued by UKEF's former Insurance Services Group (the main part of which was privatised on 1 December 1991).
- Account 2 relates to the credit risk arising from guarantees and insurance policies issued for business since April 1991.
- Account 3 relates to guarantees issued since April 1991, on the written instruction of ministers, that UKEF's Accounting Officer advised did not meet normal underwriting criteria.
- Account 4 relates to the provision of support for Fixed Rate Export Finance (FREF) to banks (now closed for new business), together with arrangements for reducing the funding cost of FREF loans and for certain interest rate swap arrangements.
- Account 5 relates to the provision of direct lending (since 2014).

24 See accounts: Note 19 (pages 176 to 178) for a detailed explanation of the fund basis of accounting, which we apply for our insurance policies and guarantees.

Management Commentary — 5-year summary

	2015-16 £m	2014-15 £m	2013-14 £m	2012-13 £m	2011-12 £m
Overall Value of Guarantees and Insurance Policies:					
Issued and Effective - Net of reinsurance/counter-guarantees	1,507	2,685	2,272	4,291	2,318
Amounts at Risk - Gross of reinsurance/counter-guarantees	17,111	18,672	17,195	18,141	14,280
Statement of Comprehensive Net Income:					
Premium Income Net of reinsurance/counter-guarantees	73	104	120	133	85
Staff, other administration and operating costs	30	31	26	20	20
Net Operating Income – total	**106**	**129**	**50**	**135**	**147**
– Account 1	33	41	18	66	53
– Account 2	64	81	19	59	85
– Account 3	-	-	-	-	-
– Account 4	6	7	13	10	9
– Account 5	3	-	-	-	-
Statement of Cash Flows:					
Claims Recoveries – total	**133**	**115**	**108**	**98**	**90**
– Account 1	49	44	38	36	32
– Account 2	84	71	70	62	58
Interest Recoveries in the year – total	**28**	**25**	**27**	**38**	**38**
– Account 1	24	22	23	30	29
– Account 2	4	3	4	8	9
Claims Paid – total	**5**	**6**	**13**	**7**	**6**
– Account 1	-	-	-	-	-
– Account 2	5	6	13	7	6
Net Cash Flow from Operating Activities – total	**199**	**237**	**205**	**274**	**192**
– Account 1	73	65	59	66	56
– Account 2	109	165	138	198	124
– Account 3	-	-	-	-	-
– Account 4	5	6	8	10	12
– Account 5	12	1	-	-	-
Statement of Financial Position:					
Recoverable Claims before provisioning	**876**	**996**	**1,075**	**1,228**	**1,314**
– Account 1	539	583	609	675	716
– Account 2	337	413	466	553	598
Recoverable Claims after provisioning	**429**	**531**	**605**	**711**	**750**
– Account 1	234	264	284	317	321
– Account 2	195	267	321	394	429
Interest on Unrecovered Claims after provisioning	**134**	**143**	**146**	**155**	**151**
– Account 1	133	142	145	153	148
– Account 2	1	1	1	2	3
Underwriting Funds - Net of reinsurance/counter-guarantees	**547**	**553**	**542**	**478**	**396**
– Account 1	**-**	**-**	**-**	**-**	**-**
– Account 2	547	553	542	478	396
– Account 3	-	-	-	-	-
Direct Funding loans	**119**	**82**	**104**	**138**	**178**
– Account 4	51	75	104	138	178
– Account 5	68	7	-	-	-

Account 1
The main activity relating to this account is the administration and collection of the claims paid out against these guarantees and insurances. In accordance with standard accounting practice, UKEF provides prudently against the possible non-recovery of debts. Where the outlook for recovery improves, the level of provision is reduced accordingly, releasing profit to the Statement of Comprehensive Net Income. The key results (rounded to the nearest million) were as follows:

- Operating income was £33 million, an decrease from operating income of £41 million in 2014-15.
- Recoveries of claims paid were £49 million compared with £44 million in 2014-15.
- Recoveries of interest on claims paid were £24 million compared with £22 million in 2014-15.
- The balances for gross claims decreased from £583 million in 2014-15 to £539 million during the year, while those for net claims decreased from £264 million in 2014-15 to £234 million during the same period.
- Interest on net unrecovered claims has decreased from £142 million in 2014-15 to £133 million.
- All non-claims exposure on this account has run off in 2015-16.

Account 2
The key results were as follows:

- The total of guarantees and insurance policies that were issued and effective during the year was £1,507 million compared with £2,685 million at 31 March 2015.
- Net premium income was £73 million compared with £104 million in 2014-15.
- Net operating income was 64 million compared with £81 million in 2014-15. The decrease in net operating income was due to a smaller release from funds closing in 2015-16 of £36 million compared with £52 million in 2014-15; and to a foreign exchange gain of £5 million in 2015-16 compared with a gain of £14 million in 2014-15.
- Claims authorised and paid or payable during the year decreased to £5 million from £6 million in 2014-15.
- Claim recoveries for the year were £84 million compared with £71 million in 2014-15.
- Gross claims balances were £337 million compared with £413 million in 2014-15.
- Net claims balances were £195 million compared with £267 million in 2014-15.

Account 3
No new guarantees were issued or claims made on this account during the year. There was no income for the year, as was the case for 2014-15, and all exposure on this account has run off.

Account 4
The results were as follows:

- The direct funding balance represents the funds originally loaned by HM Treasury to reduce the cost of FREF. The balance continued to reduce during the year to £51 million from £75 million in 2014-15, as regular instalments were made.
- Net operating income was £6 million in 2015-16 compared with £7 million in 2014-15.

Account 5
This account relates to direct lending activity. During the year 5 new loans were originated (one loan originated in 2014-15).

All accounts
Operating expenses improved to £30 million in 2015-16 compared to £31 million in 2014-15. While there was a planned increase in staff costs, this was offset by lower marketing spend and other administration costs.

For the reasons set out above (see Accounts 1 and 2), the major asset of UKEF, being net recoverable claims, decreased from £531 million in 2014-15 to £429 million during the year. Gross claims also reduced from £1.0 billion to £0.9 billion.

Due to the strengthening of the US dollar over the financial year by some 3%, there has been a foreign exchange gain of £13 million compared with a gain of £34 million in 2014-15.

Explanation of variances between estimate and outturn summary

Parliament sets a limit on the annual amount of resource and capital that UKEF can consume through the supply estimates process. The table below compares UKEF's estimate with actual outturn. Further information on the supply estimate is available on UKEF's website at ***www.gov.uk/uk-export-finance***

In the absence of any operating income outside the ambit of the estimate, UKEF's net resource outturn and net operating cost or income are identical.

UKEF supports export credit loans denominated in foreign currency and as a result is exposed to foreign currency exchange risk arising from fluctuations in exchange rates of various currencies. Almost all of UKEF's premium income arises in currencies other than sterling (mostly US dollars) and net assets are denominated in a variety of currencies, of which the largest is US dollars. As UKEF is not authorised by HM Treasury to hedge exchange rate exposures, it faces challenges to ensure compliance with Parliamentary voted control totals. From January each year, which is the last opportunity to adjust voted control totals, to 31 March there is a risk that exchange rates move and reduce net income by more than the headroom agreed with HM Treasury and voted by Parliament.

Explanation of variances between estimate and outturn summary

	SOPS Note	2015-16 Estimate £'000	2015-16 Outturn £'000	2015-16 Variance £'000
Budget spending:				
Departmental Expenditure Limit (DEL)	SOPS1(a)	1	-	1
Annually Managed Expenditure (AME)	SOPS1(a)	32,515	(106,341)	138,856
Resource Total & Net Operating Cost / (Income)		**32,516**	**(106,341)**	**138,857**
Non Budget / Resource Total	SOPS1(a)	-	-	-
Net Resource Outturn & Net Operating Cost / (Income)		**32,516**	**(106,341)**	**138,857**
Budget spending:				
Departmental Expenditure Limit (DEL)	SOPS1(b)	300	-	300
Annually Managed Expenditure (AME)	SOPS1(b)	403,290	33,874	369,416
Capital Total Payments / (Receipts)		**403,590**	**33,874**	**369,716**

Significant highlights

All UKEF income and expenditure is classified as either DEL or AME and there is no non-budget.

Resource – Note SOPS1(a):

AME £139 million – This variance is largely due to provision and foreign exchange movements which are difficult to forecast.

Capital – Note SOPS1(b):

AME £369 million – This variance is largely due to the new direct lending facility. It is difficult to forecast drawings and the likely take-up.

As it has become a direct lender, UKEF has adopted the Equator Principles, a global framework to promote sustainable environmental, social and human rights decision-making in financing projects.

This is in addition to its existing longstanding commitments to international standards agreed through the OECD.

Head of Environmental and Social Risk's report Helen Meekings

We examine environmental, social and human rights (ESHR) risks and potential impacts of projects UKEF is asked to support in line with our published ESHR policy.[25] In addition, we collaborate with other export credit agencies in the field of ESHR matters with the aim of establishing a 'level playing field' in respect of ESHR risk management across export credit agencies. We also engage more broadly with international financial institutions through participation in external forums and sharing of experiences.

During 2015-16 we screened transactions that fell within the scope of the Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence[26] (OECD Common Approaches). Where we identified significant risks, these transactions were categorised as A (high risk) or B (medium risk) and we carried out an ESHR due diligence review.

Our ESHR due diligence is carried out in-house by a team of professionally qualified and experienced staff, sometimes supported by external technical ESHR consultants. In undertaking ESHR reviews, we place emphasis on early dialogue with exporters and with other parties to the transactions. The aim is to ensure that the projects to which the exports are destined align with the relevant international ESHR standards. These are typically the International Finance Corporation's (IFC) performance standards on environmental and social sustainability.

ESHR due diligence

In 2015-16 we worked with a wide variety of project developers and exporters to help them understand and manage the ESHR risks associated with their project activities. The following are examples of projects supported in 2015-16 where UKEF contributed to better ESHR risk management.

Liwa plastics project in Oman[27]

We took a leading role within the export credit agency lender group in undertaking ESHR due diligence and developing a multi-party ESHR work plan to meet financing time frames. The project was classified as high ESHR risk, category A. This project will be monitored over the duration of our support with the aim that the project will be constructed and operated in line with the relevant international standards.

Floating, production, storage and offloading (FPSO) vessel in Brazil

We worked in collaboration with other export credit agencies in undertaking ESHR due diligence, before providing a counter guarantee to the export credit agency of the Netherlands. The project was classified as high ESHR risk, category A. The shipyard where the FPSO is being fitted out will be monitored during construction and ongoing monitoring will take place with the aim that the FPSO will be operated in line with the relevant international ESHR standards.

25 *https://www.gov.uk/government/publications/uk-export-finance-environmental-social-and-human-rights-policy.*

26 *http://www.oecd.org/tad/xcred/oecd-recommendations.htm.*

27 Our support for the Liwa plastics project was issued on 7 March but did not become effective until after 31 March, so will be accounted for in the Annual Report and Accounts for 2016-17. However the ESHR due diligence was completed in 2015-16 so has been reported here.

The Blue Waters Island development in the United Arab Emirates

We worked closely with the project developer in understanding the relevant ESHR risks and impacts associated with the project. It was classified as medium ESHR risk, category B, with impacts expected to be localised and mitigation measures readily available. Our support focused on better understanding and managing associated labour risks, particularly migrant labour.

You can find details on our website at ***www.gov.uk/uk-export-finance*** of the ESHR risk and impact categorisation of civil (non-aerospace) cases for which support was issued during 2015-16 that fell within the scope of the OECD Common Approaches.

ESHR monitoring

UKEF monitors its category A and category B projects where support has been issued. This enables us to track the implementation of ESHR commitments and to be satisfied that the projects continue to align with the relevant international standards during both construction and operations. Monitoring includes reviewing self-monitoring reports produced by the project developers, monitoring conducted by an independent environmental and social consultant (IESC) on behalf of UKEF, or UKEF carrying out site monitoring visits. The level and frequency of our monitoring varies according to the ESHR risks involved.

UKEF seeks to positively influence the ongoing alignment with the relevant international ESHR standards throughout the monitoring process, with the aim of improving and attaining positive and tangible ESHR outcomes. This may include influencing the project developer:

- to promote positive health and safety behaviors, minimising accidents, injury and loss of life
- in re-establishing affected people's livelihoods
- in the provision of appropriate worker conditions and accommodation
- in promoting positive project impacts

The following are examples of our ongoing monitoring commitments met in 2015-16.

Nghi Son refinery and petrochemical project in Vietnam

In collaboration with the other export credit agencies within the lender group, we helped in enabling community resettlement in a manner consistent with the IFC performance standards. This is a high ESHR risk, category A project, currently in its construction phase. Primary risks of particular concern relate to occupational health and safety during construction. The lender group has maintained a dialogue with the project developer. The group has undertaken site monitoring visits, and an IESC undertakes ongoing monitoring. The aim is to encourage positive health, safety and environmental practices on-site and at the project fabrication yards so that ESHR standards are maintained.

Sadara production complex in Saudi Arabia

Together with other export credit agencies, we have provided clarity on the requirements of the IFC Performance Standards to the project management teams. The clarifications have led to changes in a self-monitoring system for worker accommodation sites and enhanced conditions to maintain ongoing alignment with the relevant international ESHR standards.

Brazilian state oil and gas company (Petrobras)

We undertake an annual partnership visit to Petrobras's environmental, health and safety team as part of our monitoring of their line of credit. The visit includes discussion on good international industry practice on environmental and social management systems in the oil and gas sector. The 2015 visit extended to the UK exporters providing services to Petrobras under the UKEF line of credit. We met with their ESHR teams to monitor how they are managing their ESHR risks in line with the international standards and Petrobras's ESHR management systems.

Gas power plant in Turkey

At the request of the project sponsor, we provided technical and tailored guidance to the project sponsor on meeting its environmental surveying requirements to enable the power plant project to align with the necessary requirements of the international ESHR standards.

A summary of cases that fall within the scope of the OECD Common Approaches where we are undertaking ongoing ESHR post-issue monitoring can be found on our website at ***www.gov.uk/uk-export-finance***.

International ESHR co-operation

In supporting UKEF's objective to achieve fairer competition by seeking to establish a 'level playing field' for all OECD exporters, we work alongside other export credit agencies at the OECD Environmental and Social Practitioners' Group of the Export Credit Group (ECG). We are actively involved in setting agenda items, sharing experiences and seeking to achieve consistency of approach to risk management practices of export credit agencies fulfilling the requirements of the OECD Common Approaches. The ECG's Environmental and Social Practitioners' Group provided technical input to the discussions on the need to amend or undertake a review of elements of the OECD Common Approaches.

We hosted the ECG's Environmental and Social Practitioners' Group meeting in London in May 2015. UKEF was influential in setting the agenda and invited representatives from an exporting business, a human rights non-governmental organisation and a development bank to present and participate in the discussions. We have taken a lead on a number of ESHR issues and working groups with a view to obtaining consistency of practice by export credit agencies.

We also participate in a number of multilateral financial institution ESHR practitioner meetings. This included the IFC community of learning where, alongside the IFC, we jointly hosted 2 thematic technical sessions for ESHR professionals from various other development banks, commercial banks and export credit agencies.

Other ESHR matters

UKEF joined the Equator Principles on 31 March 2016. Our ESHR policy was updated to reflect this and is available on our website.[28]

Helen Meekings, MEng, PhD, CEng, MICE
Head of Environmental and Social Risk
23 June 2016

28 *www.gov.uk/government/publications/uk-export-finance-environmental-social-and-human-rights-policy.*

The Export Guarantees Advisory Council reviews UKEF-supported projects which have been classified as high, medium or low impact, to examine UKEF's application of environmental, social and human rights policies.

Export Guarantees Advisory Council annual report

Introduction

The Export Guarantees Advisory Council ('the Council') is a non-departmental public body (NDPB) established under the Export and Investment Guarantees Act 1991. Its role is to advise the Secretary of State for Business, Innovation and Skills on the policies that UKEF applies when doing business, particularly those related to:

- environmental, social and human rights
- anti-bribery and corruption
- sustainable lending
- disclosure, in line with information legislation

The Council's advice is provided in the context of the government's export strategy and the role UKEF plays to support exports while applying ethical policies established by international agreements that relate to export credit agencies.

The Council does not have executive powers and therefore is not involved in decision-making relating to UKEF support for particular export transactions. It does, however, carry out retrospective reviews of export transactions UKEF has supported to understand how ethical policies are applied in practice, to give assurance and, where appropriate, advise on how these might be further developed.

Membership

Members of the Council are appointed by ministers. Members of the Council are not remunerated but provide their services on a voluntary basis. The current members are as follows.

Chair

Andrew Wiseman (Partner, Harrison Grant Solicitors)

Members

Gillian Arthur (Head of Philanthropy Services, Sanne Group)

Alistair Clark (Corporate Director, Environment and Sustainability Department, European Bank for Reconstruction and Development)

Alexandra Elson (Senior Stakeholder Relations Adviser, Shell plc)

Neil Holt (former Director, Ethics and Business Conduct, CH2M HILL Group, Trustee, Transparency International)

John Newgas (Consultant, Sagwen Computer Consultancy)

Anna Soulsby (Associate Professor of Organisation Behaviour, Nottingham University Business School)

Meetings and attendance

During 2015-16, the Council met on 5 occasions. Separately, it met with the Minister of State for Trade and Investment.

Senior officials from UKEF, including its Chief Executive, attended the Council's meetings. They briefed the Council on current issues and developments and the export transactions supported. It is the practice of the Council to also meet outside parties to discuss issues of interest to help inform the Council's agenda. The Council continued with its regular meetings with stakeholders. This year it met with the British Exporters Association (BExA).

Environmental, social and human rights due diligence

UKEF undertakes environmental, social and human rights (ESHR) due diligence when it is asked to support projects where the *OECD Recommendation on Common Approaches for Officially Supported Export Credits* and Environmental and Social Due Diligence (OECD Common Approaches) applies. This agreement informs the way in which member export credit agencies should address ESHR due diligence. This includes screening and classifying projects according to their potential ESHR risks and carrying out reviews and monitoring accordingly. These processes seek to assure export credit agencies that projects are constructed and operated in line with local laws and relevant international ESHR standards. It is UKEF's practice to benchmark applicable projects against the International Finance Corporation (IFC) Performance Standards. The Council reviews projects for which UKEF support has been sought and which have been classified as high (category A), medium (category B) or low (not categorised) impact, to examine UKEF's application of the OECD Common Approaches. The Council reviews the due diligence carried out for projects after UKEF support has been provided and also in respect of projects where UKEF is monitoring ESHR performance during the construction and operations phases.

These projects employed a significant number of workers for their construction and, therefore, the Council paid particular attention to labour and working conditions and the human rights of workers. The Council examined how UKEF had applied the relevant IFC Performance Standards and International Labour Organization requirements to each project. UKEF demonstrated the due diligence it and other export credit agencies had undertaken to be assured that the project sponsors were committed to applying international standards. Given concerns about the standard of some of the workers' accommodation at one of the projects, the Council was able to see, for example, how UKEF (and other export credit agencies) were able to obtain improvements. UKEF also demonstrated to the Council the ongoing work it is undertaking with project sponsors of a project in Saudi Arabia to remediate a pollution incident in line with local and international standards. In relation to the oil refinery upgrade and petrochemical project in India, UKEF has undertaken site visits and other activity to actively monitor the project in the post issue stage.

The Council also reviewed a new project in Russia that UKEF had supported which was classified as Category B. This project was supported alongside OeKB, the Austrian export credit agency. The Council reviewed UKEF's determination of the classification, the ESHR due diligence undertaken and its collaboration with OeKB.

The Council observed that there was an increasing number of UKEF-supported projects that were now being monitored in the construction and operational phases. UKEF was able to demonstrate its commitment to monitoring such projects throughout the life of UKEF support. UKEF seeks to be assured of ongoing alignment with international standards through self-reporting by project sponsors, reports made by independent environmental consultants and/or through UKEF staff conducting site visits.

The requirements of the OECD Common Approaches in respect of post-issue monitoring of projects are not as prescriptive as the ESHR due diligence process it asks export credit agencies to follow when they consider supporting a project. UKEF reported to the Council other export credit agencies' post-issue monitoring processes. There are a range of approaches, from those who do little, to those like UKEF who routinely carry out monitoring for projects classified category A or B. This is an area of the OECD Common Approaches which could be strengthened so that there is consistency of practice. These changes will help discipline project sponsors to adhere to commitments to construct and operate projects in alignment with international standards.

At the request of the Council, UKEF also undertook research to establish the practices of other export credit agencies in respect of human rights issues, including for export transactions that are not within the scope of the OECD Common Approaches. Again, there is variability in approach, with some export credit agencies undertaking human rights due diligence for all business, while other export credit agencies, including UKEF, apply, but do not go beyond, the OECD Common Approaches.

During the year, the OECD Export Credit Group and the OECD Environmental and Social Practitioners' Group (ESPG) considered revisions in the 2012 OECD Common Approaches in response to a mandate contained therein to undertake a review no later than 3 years after its adoption. UKEF reported to the Council the deliberations of the OECD Export Credit Group/ESPG, which culminated in proposals to make clarifications in respect of human rights and greenhouse gas reporting. A revision to the OECD Common Approaches was published on 6 April 2016.

UKEF hosted a meeting of the ESPG in London in 2015, which provided an opportunity to shape the group's ESHR agenda and establish a programme of work for the future. The Council welcomed UKEF's efforts to help lead the ESPG and influence export credit agency ESHR policy and practice. UKEF is now leading a number of initiatives that flowed from the London meeting. Over time, these initiatives should help raise standards and achieve consistency in how ESHR issues are approached.

During the year, the Council was briefed about the efforts made by the OECD Export Credit Group to restrict export credit agency export credit financing support for coal-fired power stations. This was in response to concerns about their egregious environmental impacts. UKEF, alongside the US export credit agency, US Ex-Im Bank, took a leading role in obtaining an agreement to curtail export credit agency support for coal-fired power stations. This culminated in an agreement being reached to tighten the terms of export credit agency support for such projects. The agreement fed into the climate change talks held in Paris in November 2015. The new terms have been set out in a Sector Understanding attached to the *OECD Arrangement on Officially Supported Export Credits.*

During the year, the Council considered an initiative by UKEF to adopt the Equator Principles. The Equator Principles have been established to guide banks and other financial institutions on ESHR matters when they provide financing for projects and are, to a large degree, similar to the OECD Common Approaches. A number of export credit agencies, all with direct lending capability, have adopted the Equator Principles. UKEF's application was made in the light of UKEF becoming a direct lender, but also to gain access to another source of ESHR advice and support, and to strengthen UKEF's relationship with the IFC, which sets the benchmark ESHR standards. The Council welcomed this development and encouraged UKEF to adopt the Equator Principles, which it did on 31 March 2016.

The OECD Common Approaches require member export credit agencies to publish statements on their policy, practice and approach to ESHR issues. UKEF consulted the Council on the production of a policy and practice statement, which would include the adoption of the Equator Principles. The policy and practice statement was published on UKEF's website on 31 March 2016.

Anti-bribery due diligence

UKEF applies the *OECD Recommendation on Bribery and Officially Supported Export Credits* (OECD Bribery Recommendation), which guides member export credit agencies on addressing anti-bribery due diligence in respect of transactions they are asked to support. UKEF operates anti-bribery policies and practices that align with the OECD Bribery Recommendation. In essence, UKEF carries out due diligence before providing support for exports. This is to ensure, within reason given that UKEF does not have investigatory powers, that projects provided with support are not tainted by bribery. UKEF has recourse rights so that if it transpires that bribery was involved after support has been provided and UKEF suffers losses, such losses can be recovered from the exporter.

The Council reviews the application by UKEF of the OECD Bribery Recommendation. The Council considers an annual report from UKEF on its application of the OECD Bribery Recommendation which includes the number of applications made, those involving the use of agents, the use of special arrangements for the handling of information about the identities of agents (special handling arrangements), etc. The report provides a picture of anti-bribery due diligence carried out over the year by UKEF. From time to time, the Council also examines particular transactions UKEF has supported. For example, the Council reviewed a transaction involving the supply of a floating production storage and offloading unit leased by SBM BV to Brazil's national oil company Petrobras. This was against a background where SBM had been fined for bribery offences and where Petrobras had been at the centre of a bribery investigation in Brazil. The Council was satisfied that UKEF had followed the OECD Bribery Recommendation and its policy on the provision of support for companies convicted of bribery offences, taking account of the reforms made by the parties to strengthen their anti-bribery policies and practices in the wake of the circumstances each had encountered.

As foreshadowed in the Council's annual report last year, the Council was consulted about the government's proposed response to a public consultation on changes to UKEF's anti-bribery practices. The proposed changes included simplification of the anti-bribery and corruption declarations and undertakings, application of anti-bribery and corruption procedures to new products not linked to a specific export contract, and the approach to holding public consultation on future changes to anti-bribery and corruption provisions and procedures. The Council held a special meeting to consider the submissions made by interested parties and advised UKEF accordingly.

The Council was also consulted by UKEF on a proposal to change the way it provides support for export working capital and contract bonds offered via banks. Under the proposed new model, banks would decide on whether a transaction would benefit from our support using criteria set by UKEF. If adopted this would avoid the duplication of due diligence processes that are currently carried out by both banks and UKEF. The Council was consulted on the arrangements that might be put in place for banks conducting anti-bribery due diligence. It concurred with the proposal that UKEF, rather than the banks, should continue to carry out anti-bribery due diligence for transactions where the use of agents are involved, taking into account the greater risks of bribery being passed through third parties. UKEF is trialling the new arrangements to see how they work out in practice before rolling them out more widely.

Sustainable lending

UKEF applies the OECD Principles and Guidelines to Promote Sustainable Lending and the Provision of Official Credits to Low Income Countries (OECD Sustainable Lending Principles). The Principles set out the basis on which export credit agencies should support transactions and projects for poor, highly indebted, countries. The aim is to avoid such countries contracting unsustainable levels of commercial indebtedness. The Council reviews projects UKEF has supported in countries that fall under the OECD Sustainable Lending Principles. During the year UKEF considered export credit financing support for a number of projects in sustainable lending countries, but none reached financial close during the year.

The Council's advice was sought on the government's proposals to establish a concessional export credit facility. The Department for International Development undertook a public consultation to canvass views from interested parties. Taking into account the OECD Sustainable Lending Principles, which have established guidance on mixing aid with commercial export credit lending, the Council welcomed the initiative as a way of assisting exports to poorer countries. Such a programme could have developmental benefits and help make project costs more affordable. The Council considered that such projects could benefit UK exporters in helping to achieve a level playing field against competitors who can access tied aid programmes. Moreover, recipient countries would benefit from the ESHR and anti-bribery standards that UKEF would apply. Notwithstanding government policy on the provision of aid, submissions from industry argued that the funding for the concessional element of the concessional export credit facility should be made available on an untied basis for negotiated contracts, a preferred method of contracting by British companies. This was reiterated by BExA when it met with the Council.

Stakeholder engagement

The Council met with BExA, an organisation which represents the interests of exporters and lobbies the government on their behalf. BExA welcomed the improvements made by UKEF in the provision of new products and services following the onset of the financial and economic crisis in 2008. It considered that UKEF had become more responsive to the needs of exporters through the reintroduction of support for exports conducted on short terms of credit and the introduction of the direct lending facility. BExA particularly welcomed the introduction of export finance advisers across the UK, which meant that exporters could access advice locally from UKEF personnel.

Information requests

The Council reviewed UKEF's handling of information requests made under the Freedom of Information Act and the Environmental Information Regulations during 2015-16. The Council welcomed the improvement in the proportion of requests answered within statutory deadlines.

Cost of operation and further information

The costs of operating the Council during 2015-16 amounted to circa £3,000, largely to reimburse the cost of travel and meeting expenses. The Council's terms of reference, register of members' interests, minutes of meetings and contact details can be found at ***www.gov.uk/government/organisations/export-guarantees-advisory-council***. For further information on the work of the Council please contact the Council Secretary on 020 7271 8018 or email ***enquiries@ukexportfinance.gov.uk***.

Andrew Wiseman
Chairman
23 June 2016