Performance

Members of the UKEF Board

UKEF's non-executive chair leads the UKEF Board advising 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. Profiles of UKEF Board members can be found on page 117.

Chair's report
Noel Harwerth

This report is my first as Chair of the Board of UK Export Finance, having joined in January this year. I would like to thank my predecessor, Guy Beringer QC CBE, for his leadership and commitment in the role. His stewardship has helped ensure that I am in an enviable position: at the helm of what is already one of the world's leading export credit agencies.

I am not the only new non-executive director: Oliver Peterken, Lawrence Weiss and Catherine Raines also joined during the year. On all our behalves I would like to extend my thanks to Louis Taylor, the rest of the Board and all UKEF's staff for their support in our first months in post.

This has been an eventful year both for UKEF and the UK as a whole. In June 2016, the UK voted to leave the European Union. With the subsequent formation of the Department for International Trade, UK Export Finance is now front and centre of the government's strategy to support trade. We look forward to continuing to provide world-class support to the UK's exporters and their overseas buyers as the UK grows as a global trading nation with strong relationships around the world.

At the same time as strengthening our collaborations across government working alongside the Department for International Trade, we have made considerable progress in improving our offering to our customers. In his Autumn Statement, the Chancellor announced significant increases to our capacity and flexibility, with doubled risk appetite and country limits.

UKEF will shortly publish its Business Plan for 2017-20. This new plan will position UKEF to support higher volumes of business while improving its customer experience. The scale of UKEF's ambition needs to match those of the UK's exporters, as they look to realise the world of opportunity out there for them. Over the past twelve months we have put in place strong foundations on which we can build, as we strive to be a more scalable export credit agency that is committed to the fullest extent possible to its role – supporting UK companies' global ambitions.

Noel Harwerth
Chair
3 July 2017

Scottish manufacturer Bifab manufactures steel fabrications for the energy sector. The company is 16 years old and employs over 1,000 people across two sites in Fife and a third facility at Lewis. UKEF provided support for a £100 million contract to supply wind turbine jacket substructures to the Beatrice offshore wind farm.

Chief Executive's report Louis Taylor

This year, we continued to progress towards our ambition to be the world's leading export credit agency. Buyer finance arranged for infrastructure, energy and defence business reached the highest levels since 2004. We launched a new 'Team UK' approach to attract business to the UK, boosting UK exports to international projects. We have continued to help historically high numbers of smaller companies to sustain their cashflow when taking on business overseas.

Behind the scenes we have worked hard to make progress against the objectives set out in our business plan 2014-17, notably to widen the scope of our support. We have developed more flexible trade finance products, which are to be supported by new digitised processes. The 'Team UK' approach to major projects has seen us marshalling UK suppliers of all sizes and capabilities behind our finance offers to large projects in Iraq and Egypt. These two successes – which alone have the potential to boost UK exports by over £400 million – set a template for a government-wide approach to supporting major projects in all sectors, which will see us, wherever it is appropriate, spearheading the UK offer with a strong finance package.

We also strengthened our team across all areas, with talent recruited from outside the department and promoted from within. Bhaskar Dasgupta was recruited from HSBC to a new Chief Operating Officer role; Gordon Welsh was promoted to Head of Business Group; Richard Simon-Lewis, who led Lloyds Bank's renewable energy project finance function, joined us to lead a restructured Civil, Infrastructure and Energy business team, incorporating a dedicated business development function; Pat Cauthery was promoted to lead our Aerospace and Defence business; and Davinder Mann was promoted to be our Head of Legal Division.

We welcomed Noel Harwerth as Chair of the Board, along with new non-executive directors, Oliver Peterken, Lawrence Weiss and Catherine Raines. The full composition of our Board is shown on page 117. I would also like to thank Guy Beringer for his fine stewardship of UKEF as our Chair for the last seven years.

The Department for International Trade

In July 2016, the Department for International Trade was established, with UKEF working as an integral part of its strategy and operations.

We are now a central part of the government's trade and investment strategy, while remaining a separate government department for governance and accounting purposes, and continuing to operate under the formal written consent of HM Treasury and at no net cost to the taxpayer. This arrangement allows us to maintain appropriate governance arrangements to manage the significant financial risks we take on, while benefiting from the potential to provide a more coherent service to UK business and customers abroad.

It also means many former partners within government have become close colleagues under the umbrella of the department. I am now one of the three Directors General in the Department for International Trade, in addition to my responsibilities as Chief Executive and Accounting Officer of UK Export Finance.

UK Trade & Investment has been fully absorbed into the new department reporting to the Director General, International Trade and Investment. This provides considerable opportunities to knit together their export promotion services with our tangible financial support.

Greater integration is taking places at many levels, but perhaps most significantly to date:

- new arrangements have been agreed with providers of advisory services to ensure they can exploit opportunities for UK companies to use UK Export Finance
- UKEF officials are now embedded in all High Value Campaigns and, where appropriate, will support a 'leading with finance' approach as a part of a 'Team UK' offer
- we now have the opportunity to be part of the Department for International Trade's people plan, which will help staff develop their careers and share opportunities to get the best out of one another
- we have already agreed plans to share a number of corporate functions, beginning with commercial services

Read a detailed explanation of our governance, including changes in 2016–17, in the Governance Statement on pages 121 to 135.

Measuring our success

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 our contribution helps 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. In many cases, we will work with companies and banks to ensure that commercial support is found (which we report as a 'private market assist') to satisfy the exporter's needs.

Our interventions:

- 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 a subsidy:

- we charge a premium to reflect the risk we assume
- commercial rates of interest are charged on lending we support
- the premium we charge must cover our anticipated long-term losses, as well as our operating costs
- we aim to operate at no net cost to the taxpayer over business cycles

We have reviewed our performance against each of our four 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 service and awareness: to provide a high-quality 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 towards common goals.

In 2016-17 we have continued to:

provide tangible pounds-and-pence support for UK exports – you can read the detail of this support on pages 51 to 61

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 offering 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 matches or exceeds the support provided by other export credit agencies and private finance institutions

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

improve staff engagement levels by responding to feedback from our people

cooperate across the functions of the Department for International Trade, for example to:

- develop a 'Team UK' approach to large export opportunities
- equip all front-line teams with the knowledge to fully engage on the financial challenges of trade and investment

UKEF's strategic aims:

Agile and adaptable

Competitive offering

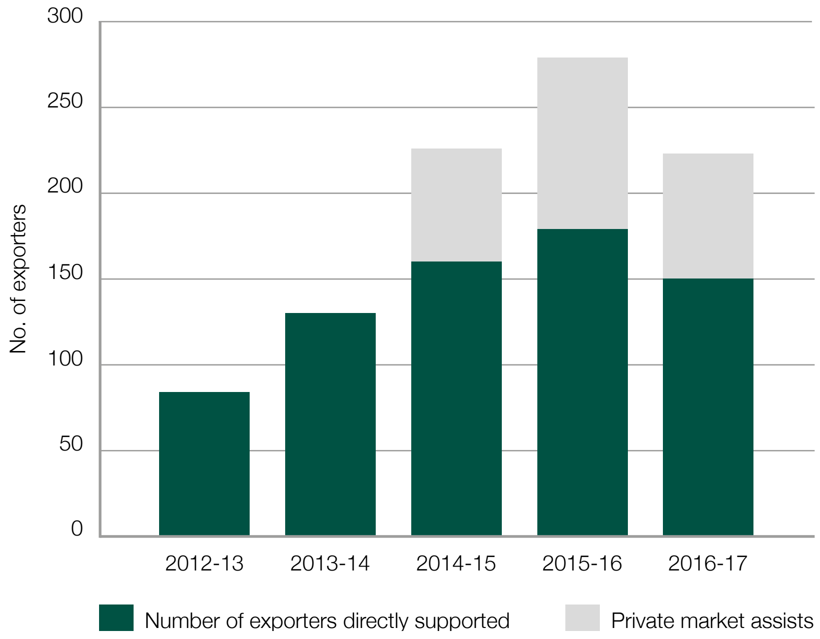
Customer service and awareness

Great place to work

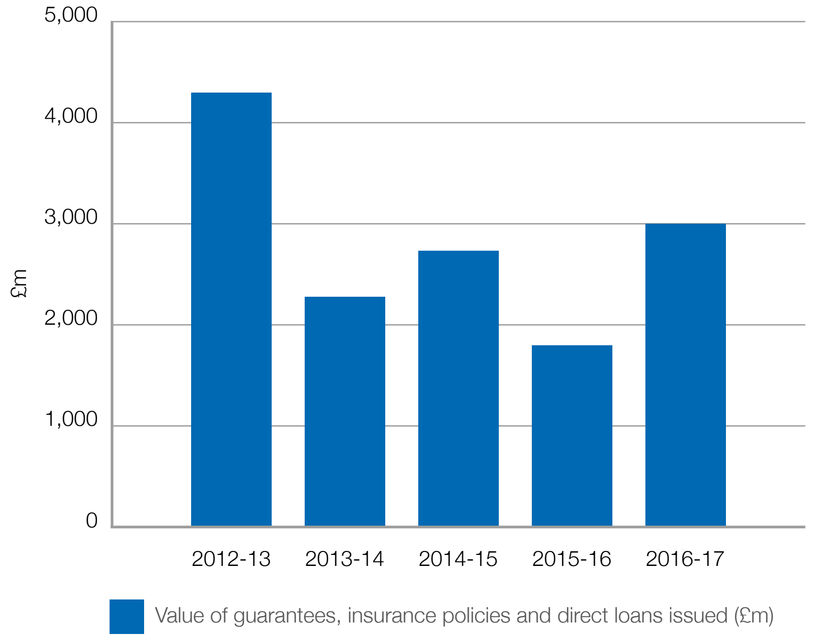
Businesses supported

We directly supported 221 companies in 2016–17. The maximum liability on all new business was £3.0 billion[1]. Our shorter-term trade finance products supported £585 million of export contracts won by UK businesses.

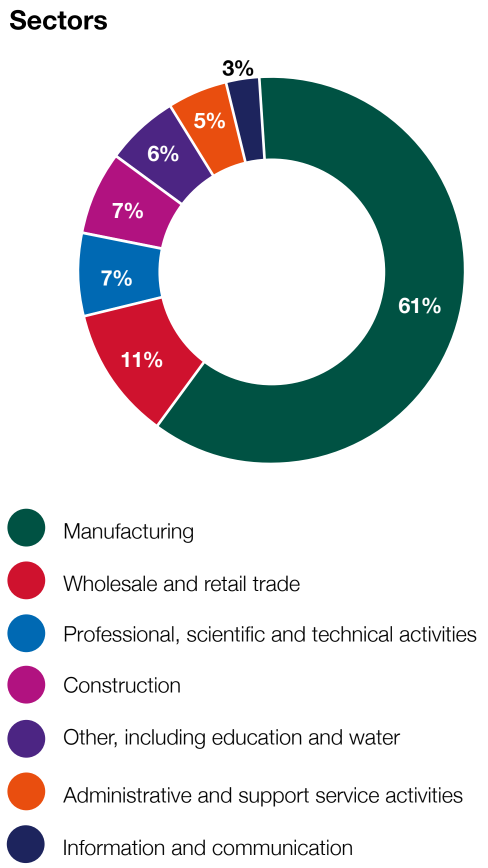
Number of exporters supported

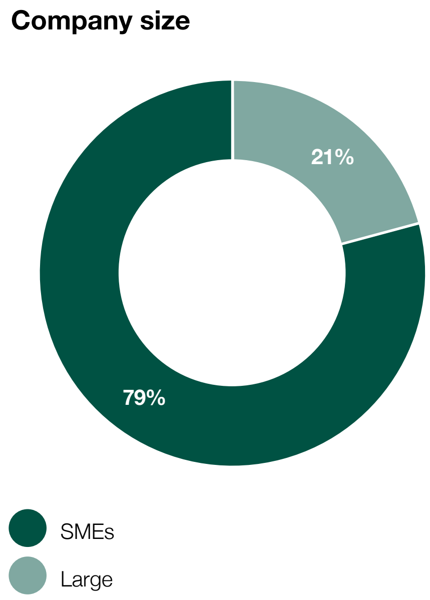


Value of business issued



1 This figure shows issued and effective business. It does not include amounts counter-guaranteed or reinsured by another official export credit agency where UKEF was acting as lead ECA on a jointly-supported transaction. It does include business supported where the private reinsurance market was subsequently used to offset risk for active portfolio management purposes. It includes £305 million in the form of direct loans and scheduled interest, which is accounted for on a different basis.

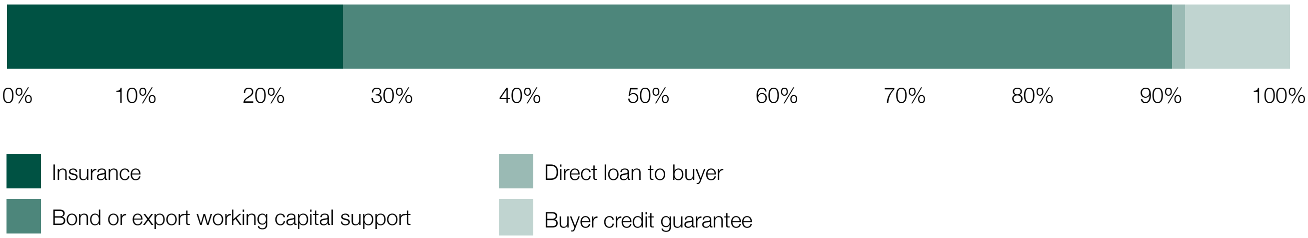




Destinations for exports supported in 2016-17
Darker shading indicates higher value of UKEF support

Product use by our maximum liability

Product use by number of companies



"UKEF exists to ensure that no viable UK export fails for lack of finance or insurance, and its support is a central part of the Department for International Trade's commitment to help exporters realise their ambitions by trading abroad."

The Rt Hon Greg Hands MP
Minister of State for International Trade

"I am doubling UK Export Finance capacity to make it easier for British businesses to export"

The Rt Hon Philip Hammond MP
Chancellor of the Exchequer
Autumn Statement 2016

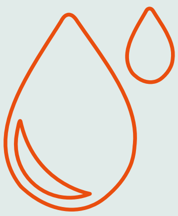
Highlights in 2016-17

We supported more than **£585 million** of new UK export contracts via our trade finance and insurance products, meaning we have now supported more than **£3.6 billion** of UK exports since these products were introduced in 2011

We became the newest member of the **African Trade Insurance** agency, offering UK exporters enhanced access to growing markets in Africa

Our total risk appetite doubled to **£5 billion** following the Chancellor's Autumn Statement, and we increased the number of pre-approved local currencies in which UKEF can offer support from **10 to 40**

We increased by up to **100%** our maximum cover limit for 30 individual markets – including Angola, Oman, the Philippines, Qatar, Rwanda, Saudi Arabia, Tanzania, Uganda and Vietnam



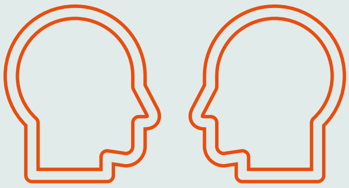
We made the first ever direct export credit loan to the **Kurdistan Regional Government** in Iraq for the development of water and wastewater treatment plants

We saw a further increase in our **direct lending** business, introduced in 2014, with **£305 million** of loans made to overseas buyers of UK exports

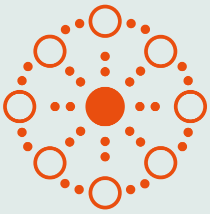
We were the first export credit agency to support an upstream oil and gas development transaction through a

hybrid finance structure

comprising both project finance and reserve-based lending



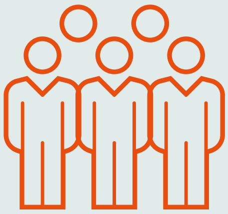
Our export finance managers held **2,994** one-to-one meetings with UK companies and **2,032** meetings with intermediaries this year



We were able to connect more than

350 companies

with the lead UK contractors for infrastructure projects in Iraq and Egypt as they sought UK suppliers due to UKEF's financial involvement

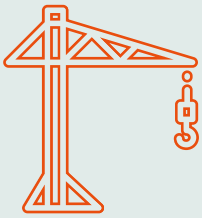


We launched our first **'Team UK'** supply chain export fairs: 98% of the companies attending highly rated the event; more than half reported gaining new leads in addition to the project business for which the event was organised

We reintroduced cover to support UK companies seeking to compete for business in Argentina, with

£1 billion

made available after a 20 year hiatus



We were recognised with

industry awards,

including Project Finance International's African Oil & Gas Deal of the Year 2016

Finances

UKEF achieved an operating surplus of £149 million for the year ended 31 March 2017 compared with £106 million for the year to 31 March 2016. The increase in net operating income was largely the result of a higher foreign exchange gain of £57 million for 2016–17 compared with a gain of £13 million in 2015–16.

We met all our financial objectives, which are set for us by HM Treasury. Page 36 sets out our results against our financial objectives and pages 95 to 101 provide a comprehensive report of our financial performance.

Supporting exports through the business cycle

Many of the loans we support by providing guarantees 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.

In this regard 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. For example, claims payments and recoveries reported in a single year actually reflect business written over a broader stretch of time. Claims paid this year relate to business issued over a 15 year period, between 2000 and 2015. The 3 new claims that arose this year stem from business issued since 2013.

Overall, this year, our performance in managing financial risk remains strong. But it is our management of risk through business cycles that is most important.

See page 67 for a more detailed commentary on how we have managed financial risk.

Performance assessment

Assessing our performance could take into account:

- the overall volume of our support (as reported on page 35)
- our ability to provide this support while covering our operating costs and losses
- the potential demand for our services, as required to complement but not compete with the private sector

Bridging the gap

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

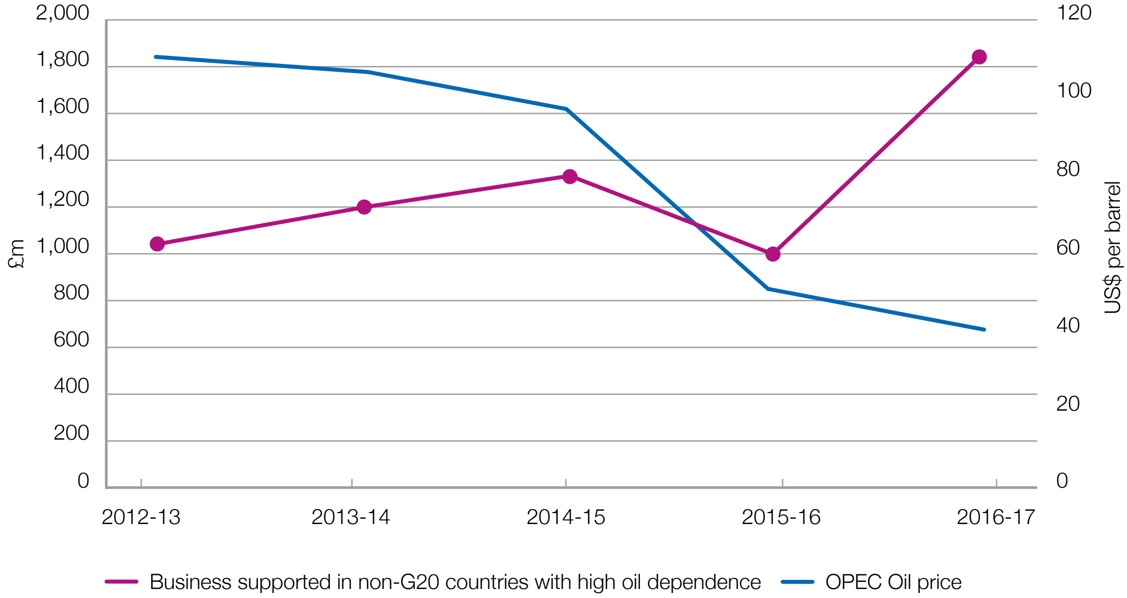
- the regulatory and economic environment and the demand for finance and insurance to support UK exports
- the ability of commercial credit insurers and finance providers to meet the market’s demand for finance

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 (for example, 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 particular market gaps

How UKEF fills market gaps: declining oil revenues

As the world oil price has fallen and remained low, UKEF has assumed more risk on buyers in countries that have a greater dependence on oil production for their revenues or wealth generation (and by doing so supporting UK exports to these markets).



Awareness

Getting our support to the right companies, at the right time, continues to be a significant focus, particularly for our trade finance products. We remain, to a large extent, reliant on banks, insurance brokers and other government networks to introduce business to us.

We continue to engage banks by offering training to their frontline staff on how they can work with UKEF to better support their clients. We are working with colleagues in the Department for International Trade to embed our finance offer within the broader offer of trade and investment support. This means becoming more prominent in government campaigns and on the great.gov.uk website. We have introduced clear pathways for trade advisers from the Department for International Trade to refer business to UKEF and have rolled out enhanced training to Department for International Trade staff in the UK and overseas on UKEF's financing options.

The Exporting is GREAT campaign, launched in November 2015, has significant potential as a channel for increasing awareness of how government can support finance or insurance for exports. Further work is needed to ensure that the UKEF offer is fully embedded and integrated within the campaign.

Our marketing and communications activity outside this campaign has been focused on data-driven prospecting of those UK companies most likely to need our support, based on analysis of their sector, size and other profile data. These companies are either:

- pulled towards projects financed by UKEF through supply chain campaigns
- engaged by partnerships with trade associations or other intermediaries
- directly offered support from an export finance manager

There is a review of our work with partners on page 63.

Pricing of risk

We support UK exporter competitiveness through the lowest premium rates permissible, subject to meeting our financial objectives and 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 77 to 79.

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.

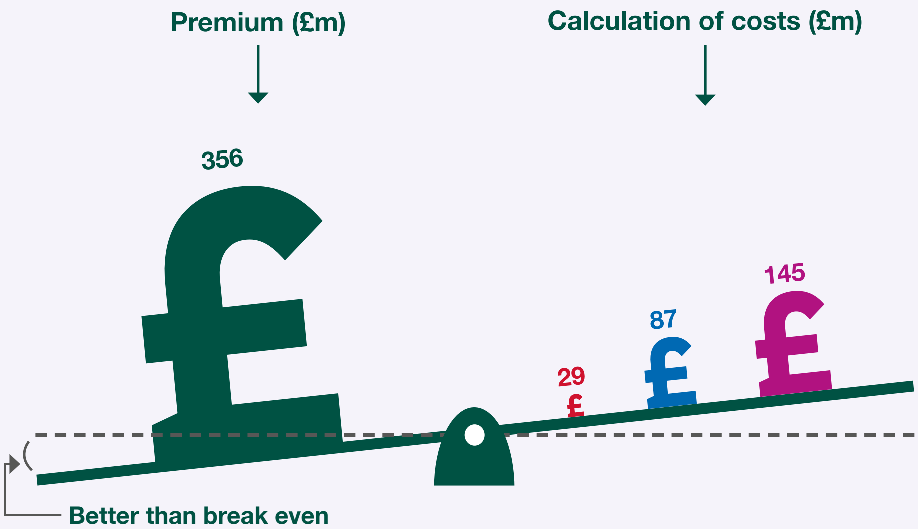
Our aim is to break even over time. To help make sure that we do, every month we calculate the premium we earn and weigh it up against an estimate of all the potential costs and losses for the business supported.

We measure this over different 3-year periods. The diagram below shows the result based on actuals for 2014 to 2017.

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

2014 to 2017



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

The position this year has not moved significantly from 2015-16, moving very slightly towards break even.

Note The premium amount for 2014-17 applied to our pricing adequacy index differs from the accounted premium reported on page 35. 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)

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 trade press such as Global Trade Review and TXF: Trade & Export Finance continues to recognise these strengths.

The strength of our guarantee in financial markets continues to be assured by our longstanding status as a ministerial government department with access to the Consolidated Fund.

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 we undertake a comparison exercise to review our offering against those 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 continue to score higher than any other export credit agency in BExA's study.

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
- occasional risk concentrations

In this context, the low volume of new claims in each of the past 5 years, from a portfolio with more than £19.5 billion at risk, demonstrates a strong capability in credit risk decision-making.

Taking the past 5 years, the average claims paid as a proportion of the average amount at risk would be 0.043% or:

£1 for every £2,307 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.

A detailed explanation of how we manage our financial risks is on pages 67 to 93.

We are also committed to managing operational risk, which involves the possibility of error or oversight leading to financial loss (other than as a result of properly managed exposure to credit risk), or a failure to properly discharge our obligations. To manage these risks, we are committed to establishing a culture of awareness and openness, enabling risks to be recognised, identified and mitigated.

There are no operational losses or special payments to report in 2016–17.

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

- operate in a continuously shifting global trade policy environment
- respond appropriately when counterparties appear not to have met their obligations in relation to anti-bribery and corruption policies
- attract and retain the right people where salary levels may lag behind private sector financial services and other public sector comparators

There is a detailed description of the most significant operational risks facing our business and mitigating measures in the governance statement on pages 121 to 135.

Support for aerospace

Our support for the aerospace sector was at a much reduced level this year relative to previous years. See page 133 of the governance statement for more information.

Operational efficiency and effectiveness

We have continued a programme of investment in digital technology and services to improve the efficiency of our case processing and customer relationship management, and to prepare for an increased uptake of our products and services.

In 2016–17 we developed the most significant changes to our trade finance offer since its launch in 2011. Our enhanced trade finance offer will be transformed by three new innovations:

- faster, simpler, clearer digital application processes
- greater delegated authority to allow financial institutions to apply our guarantee quickly and flexibly
- widened eligibility down the supply chain to include companies that supply the final exporter

Customer focus and a new business plan

In 2016–17 we invested a considerable amount of time talking to our customers and listening to their expectations of us so we can improve the way we operate and how we can better meet their needs, both online and in person. The result is a new business plan – to be published in summer 2017 – that, more than ever before, has been built around meeting customers' needs. I would like to thank all those individuals and companies that participated in this work, the fruits of which will become evident as we begin delivering our 2017–20 business plan.

In July 2016 we completed a switch from our previous IT supplier to a number of smaller providers, each with different specialisms. This significant change was in line with government guidance and, not only delivers savings, but also means we now use technology that:

- we can share across government
- we can easily maintain and scale for future use
- isn't dependent on a single third-party supplier

Review against my 2015-16 forward look

We said we would:	What we did:
• 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	• We successfully trialled a model with greater delegation of authority to banks when using our guarantee for working capital and contract bond facilities • We also renegotiated our master guarantee agreements with the banks, which will allow us to roll out an enhanced model in 2017 that will cut application times by more than half
• Provide training and toolkits to bank staff to support the use of our products under this new delivery model	• In 2016–17 we provided bespoke digital toolkits to all bank partners and began a rolling programme of training for bank relationship managers
• Trial an online application service that is simpler, faster and clearer than current arrangements	• Our online application service began live testing with bank customers in March 2017
• Develop a unified business development function that will raise awareness of our support and capabilities across the full spectrum of companies	• We now have a single business development function reporting to the Head of the Business Group, which works hand-in-hand with the communications team to manage all customer interactions with UKEF, from the point of initial awareness through to discussing an application for support with a member of the underwriting team
• Test for increasing awareness of our support	• We tested for awareness of our support and the results were equivocal; further insight work on our addressable market is being undertaken
• Reach more companies via the Exporting is GREAT campaign	• We have a new pipeline of business from companies engaged through the GREAT campaign
• Continue to collaborate across government to help finance exports	• The creation of the Department for International Trade put UKEF at the centre of collaborative efforts to support trade and investment

We said we would:	What we did:
• Implement changes to the structure of our business group under new leadership that allows for greater flexibility to marshal resource	• Following the appointments of Pat Cauthery (Head of Aerospace and Defence) and Richard Simon-Lewis (Head of Civil, Infrastructure and Energy & Head of Business Development), we now operate a more flexible deployment of underwriting expertise across cases of differing complexion under experienced leadership
• Further increase learning and development opportunities for staff that will add to their ability to support exporters	• Our overall engagement score for learning and development continues to grow which is an indication of senior management commitment to developing our people
• Invest more heavily in developing current and future leadership talent for key roles	• We have implemented a new approach to talent management and succession planning which has identified key roles and assesses the readiness of existing staff to fill them

Our people are our most valuable asset. I would like to thank all members of UKEF staff for their hard work in 2016-17.

UK Export Finance members of staff pictured in 1 Horse Guards Road, London. The UKEF offices are part of GOGGS – the Government Offices of Great George Street.

The year ahead

In July 2017 we will publish our business plan for 2017 to 2020, which describes our aims and objectives out to 2020 and how we plan to deliver them. Below are some highlights.

Addressing the market

We aim to be a more scalable organisation, able to support higher volumes of business efficiently and effectively, in particular on the short-term trade finance side.

In 2017-18 we will:

- **exploit three potential game-changers to our trade finance offer:**
  1. **the 'bank delegation' model, which allows financial institutions to apply for our guarantee quickly and flexibly**
  2. **online applications for banks and exporters using short-term products**
  3. **digitised workflow capability to process requests for support more quickly and efficiently**
- **seek to develop a new customer base though the widened eligibility of our trade finance offer**

Products

We aim to make broader use of data and market intelligence to guide our interventions.

In 2017-18 we will:

- **refresh our Overseas Investment Insurance to support UK overseas direct investment**
- **test UKEF's proposition against evolving customer needs and review products constantly for relevance to ensure we can address market gaps**

Leading with finance

We aim to further develop a 'Team UK' approach to increasing UK supplies to major infrastructure investments around the world.

In 2017-18 we will:

- **appoint around 20 corporate finance specialists in key overseas markets**
- **issue expressions of interest where possible for each relevant High Value Campaign (HVC)**

Awareness raising

We will exploit our new digital capability to increase the volume and relevance of awareness raising activity.

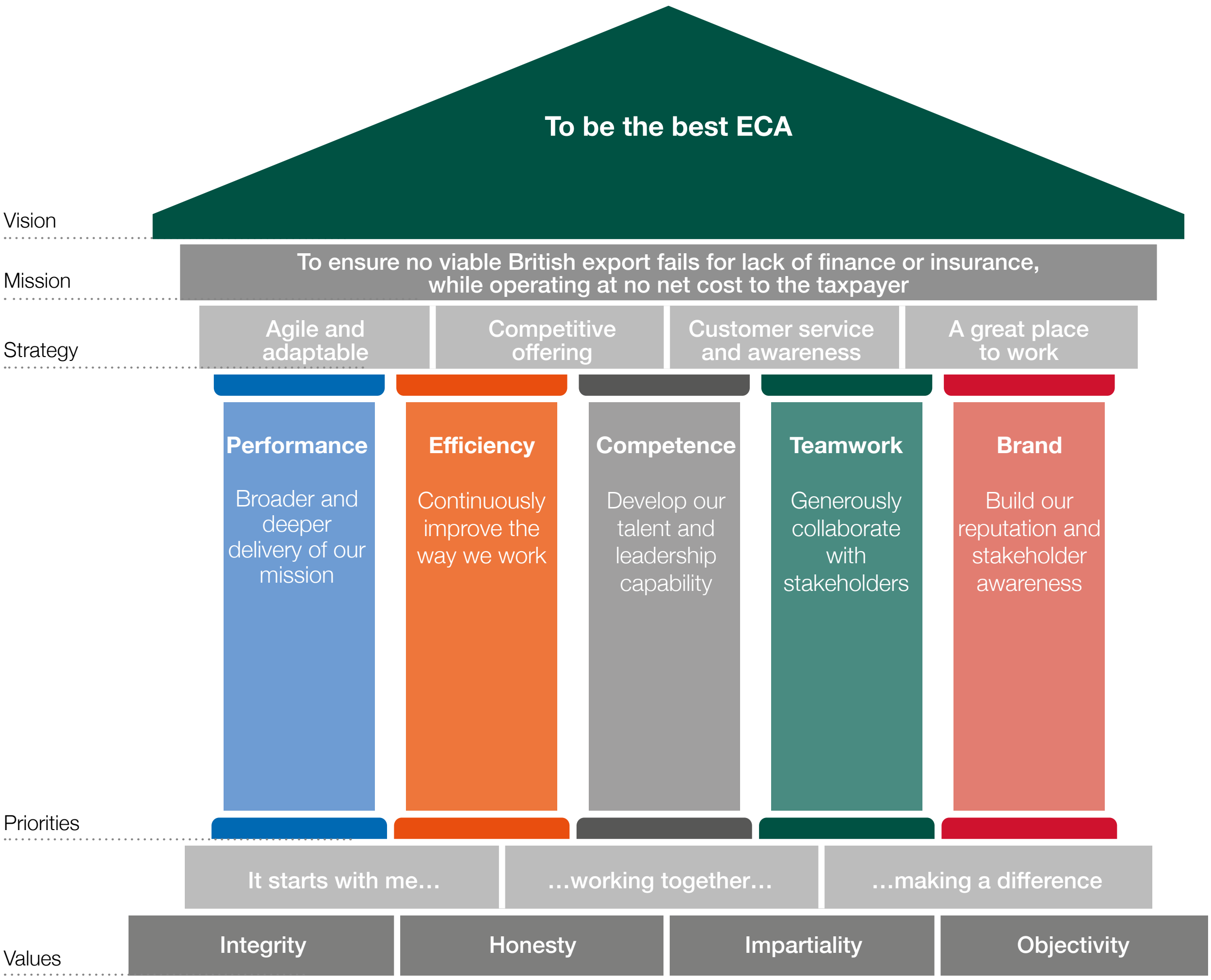
In 2017-18 we will:

- **use a more data-driven approach to define our addressable market, to better target our awareness-raising activity where it will count**
- **develop the digital toolkit available to customer-facing staff, including improved hardware, a more capable customer relationship management system, and more engaging and effective digital content**

UKEF does not need a radical new path. Instead we will increase the pace of transformation and the scale of our activity, reflecting an increased level of ambition: ambition for UK exports, for UK exporters, and for UK jobs; and for the communities served by the benefits of global trade with the UK.

Our vision, mission, strategy and priorities are set out in our Message House below.

It contains the elements which will see us lead with finance, helping UK exporters **win** new business, **fulfil** large contracts and **get paid** securely when they trade.



Louis Taylor
Chief Executive and Accounting Officer
UK Export Finance
6 July 2017

We supported Pontypool-based manufacturer, Flamgard Calidair, which is providing fire safety equipment to the Chernobyl nuclear site. This will add to the protection at the site, which is the world's largest movable structure, designed to facilitate monitoring and demolition of the previous containment building following the 1986 disaster.

Performance overview

Financial overview – 5-year summary

	2016-17	2015-16	2014-15	2013-14	2012-13
	£m	£m	£m	£m	£m
Business supported	2,966[2]	1,793	2,730	2,272	4,291
Premium income	102	73	104	120	133
Claims paid	8	5	6	13	7
Net operating income	149	106	129	50	135

Non-financial indicators – 5-year summary

Total exporters supported, of which:	221	279	226	130	84
direct support under a UKEF product	148	176	160	130	84
private market assist[3]	71	100	66	not recorded	not recorded
direct support and private market assist	2	3	0	not recorded	not recorded
Facilities issued	483	593	588	619	368
Introductions to other sources of support	2,267	1,778	1,339	not recorded	not recorded

2 This figure shows issued and effective business. It does not include amounts counter-guaranteed or reinsured by another official export credit agency where UKEF was acting as lead ECA on a jointly-supported transaction. It does include business supported where the private reinsurance market was subsequently used to offset risk for active portfolio management purposes. It includes £305 million in the form of direct loans and scheduled interest, which is accounted for on a different basis.

3 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 £22.5 billion, against a notional maximum commitment at the time of £60.9 billion (when 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 £1.5 billion, against a notional risk appetite limit of £5 billion (adjusted for foreign exchange movements).[4]
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 4.26 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 2017 was 1.36, against a target minimum of 1.00.
(ii) previous, present and next year:	**Met** This index did not fall below 1.43, against a monthly target minimum of 1.00.
(iii) present year and next 2 years:	**Met** This index did not fall below 1.47, 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 2.22, against a target minimum of 1.35.

Pages 67 to 79 set out more detail on these objectives.

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.

4 The Risk Appetite Limit was increased from £2.5 billion to £5 billion following the Chancellor of the Exchequer's Autumn Statement to Parliament on 23 November 2016.

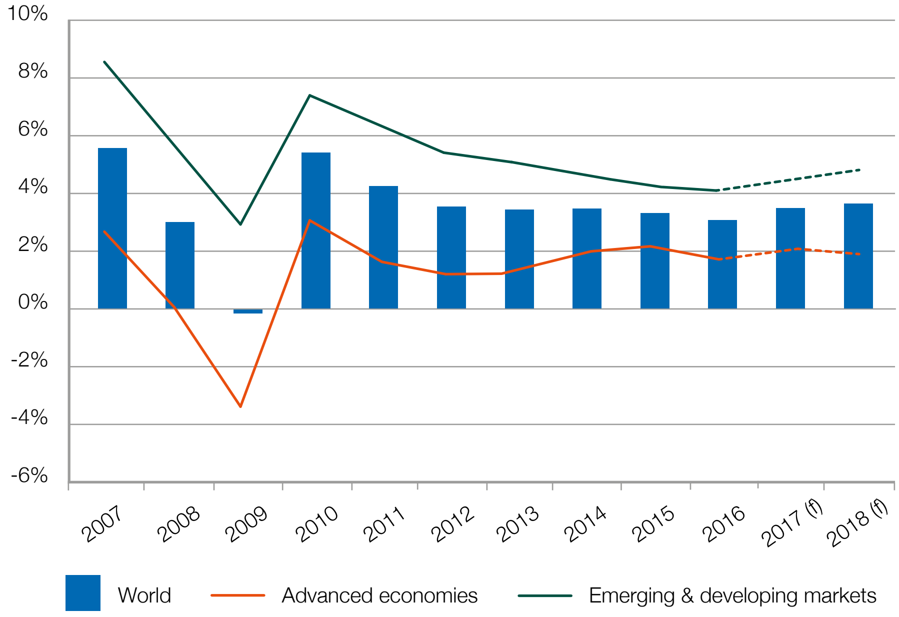
Kingswinford-based Mechatherm International supplies melting and holding furnaces to aluminium producers. The company has received a Queens Award for Exporting three times. Its recent exporting success, supported by UKEF, has seen it grow its workforce and make plans to open an office overseas.

Chief Economist's report Paul Radford

World economic growth is estimated to have slowed to 3.1% in 2016, 0.3 percentage points lower than in 2015 (3.4%) and the slowest rate of growth since 2009. This fall was driven by a loss of momentum in all of emerging markets and developing economies, and advanced economies.

In the face of weaker global economic activity and lacklustre world trade growth, demand for UKEF support showed resilience, with some modest increase in demand for medium- to long-term export credits.

Global growth



Source: IMF World Economic Outlook, April 2017

Subdued growth in advanced economies

Following two consecutive years of improvement, growth in advanced economies fell from 2.1% in 2015 to 1.7% in 2016, as uncertainty and underlying structural issues prevented a stronger performance.

The US economy grew by 1.6%, a marked slowdown from 2015 (2.6%) as a drawdown of inventories and weaker investment had an impact on activity. Despite this, declining unemployment and rising inflation led to 2 increases in the country's key policy interest rate from the Federal Reserve, in December 2016 and March 2017.

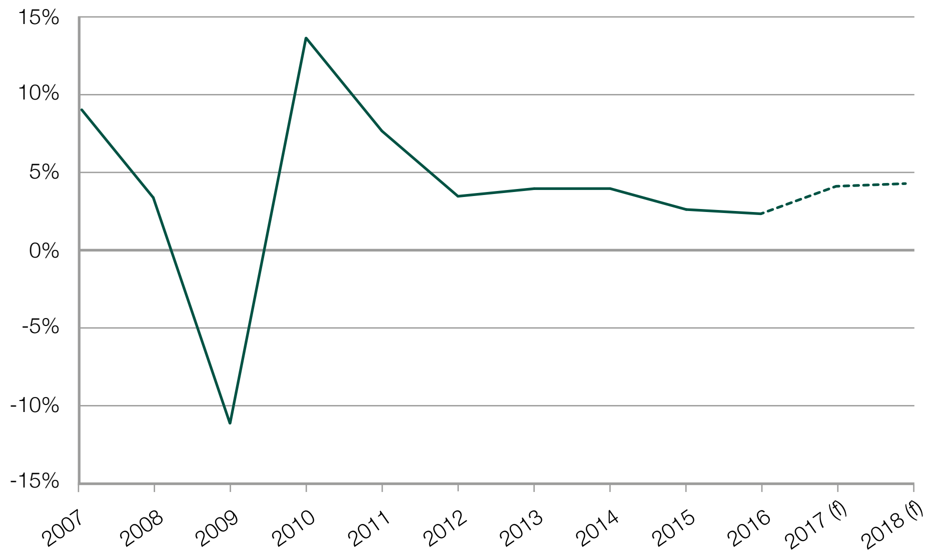
Economic activity slowed in the Eurozone, with growth rates declining from 2.0% in 2015 to 1.7% in 2016. Output remained subdued across the larger economies: Germany (1.8%), France (1.2%) and Italy (0.9%) all expanding by less than 2%.

Emerging markets

Output growth in emerging markets fell slightly from 4.2% in 2015 to 4.1% in 2016. Commodity exporters fared particularly poorly in 2016 as oil prices fell to lows of US$28 per barrel in early 2016 and averaged over 15% lower across 2016 compared with 2015. Recessions continued in Brazil (-3.6%) and Russia (-0.2%), albeit with slower contractions compared to 2015, while disruptions to oil production in Nigeria saw the economy fall into recession (-1.5% in 2016) for the first time in over 20 years. Notwithstanding slight slowdowns in China (from 6.9% in 2015 to 6.7% in 2016) and India (from 7.9% in 2015 to 6.8% in 2016), they helped contain the decline in growth for emerging markets overall. Highlighting the improving outlook for emerging credit markets, the J.P. Morgan Emerging Market Bond Index Plus (EMBI+)5 continued rising through 2016 and the start of 2017.

China's policy of transitioning from investment-led expansion to services- and private consumption-led expansion is one of the main reasons behind the weaker growth in trade, which fell to 2.2% in 2016 from 2.7% in 2015.

World trade: annual growth in volume of goods and services



Source: IMF World Economic Outlook, April 2017

US moves to normalise monetary policy have raised concerns over the potential for a reversal of capital flows from the emerging markets, potentially reinforced by higher interest rates and a strong US Dollar impacting debt servicing costs. However, recalling the 'Taper Tantrum' episode, clear and timely communication from the central banks of advanced economies have so far helped to minimise uncertainty.

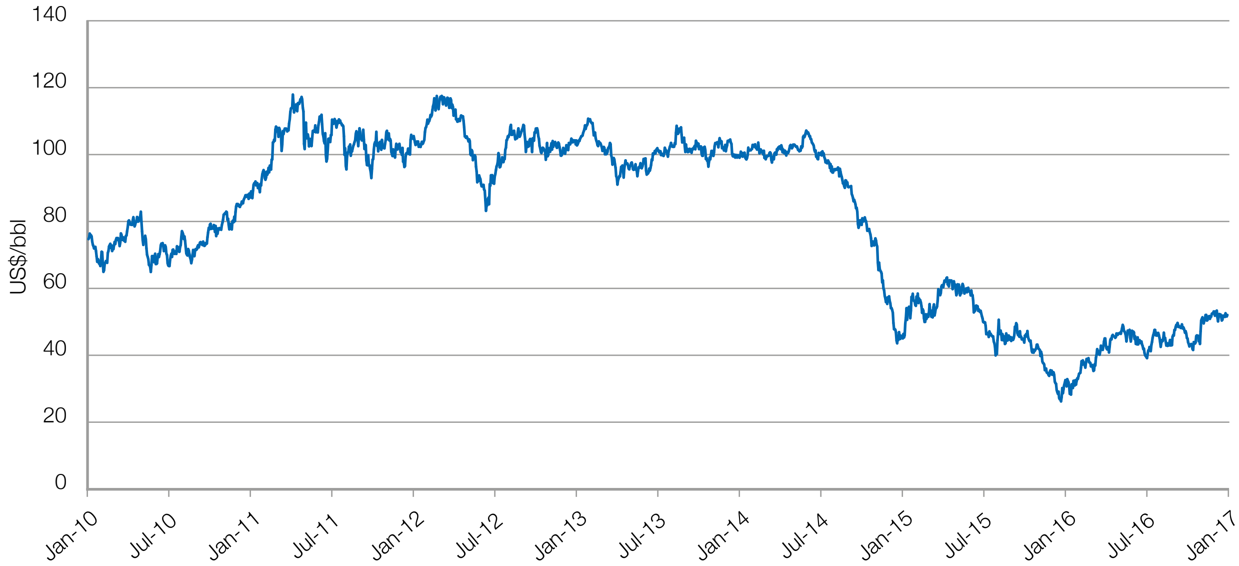
As the majority of UKEF support relates to companies exporting to emerging markets, the economic situation in these countries remains a key determinant of the department's business volumes and any increased incidence of distressed borrowers is likely to impact UKEF's business.

Firming of commodity prices

Despite averaging below 2015 levels after hitting lows at the start of the year, commodity prices recovered throughout 2016 as demand grew and supply limitations in the oil market were agreed.

Oil prices averaged their lowest for more than 10 years, falling from an annual average of US$54 per barrel in 2015 to US$45 in 2016. The agreement between OPEC members and key non-OPEC oil producers to constrain production and attempt to return the market to balance, signed towards the end of 2016 and implemented from January 2017, has bolstered prices. Nonetheless, with rising US shale production and consistently high stockpiles, it is likely that prices will remain subdued over the coming years compared to the highs seen at the beginning of the decade, but with bouts of volatility. This is illustrated in the graph below.

Brent oil US dollars per barrel



Source: Bloomberg

Metal prices, as measured by the London Metal Exchange index, rose through 2016 as a reduction in supply coupled with stronger real estate investment in China helped to firm prices. Furthermore, the expectation of increased infrastructure investment in the US alongside the modest global economic uptick could help to boost prices further.

London Metal Exchange index

Source: Bloomberg

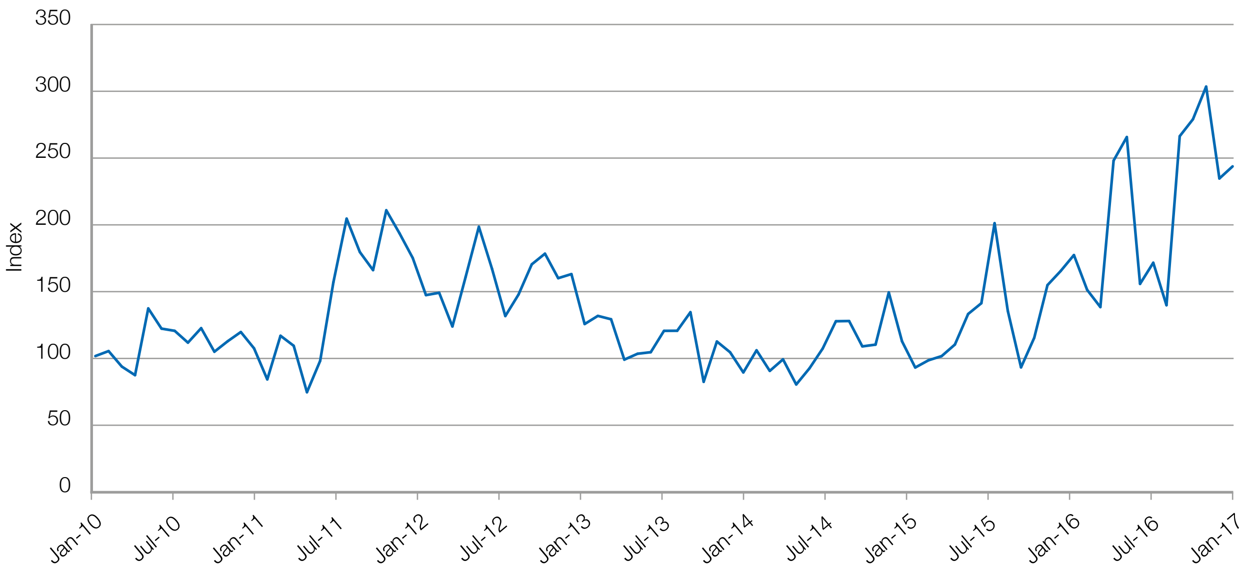
Firmer commodity prices and a linked upturn in trade volumes should underpin demand for UKEF support, with infrastructure projects that were temporarily put on hold likely to be reactivated. Furthermore, any remaining weakness in prices will drive commodity-dependent economies to seek alternative sources of funding to address infrastructure financing gaps, with export credit agency support expected to be an attractive option – especially given the sheer scale of support that may be required.

Political uncertainty

The IMF, in its current outlook for the global economy, cites several downside risks that make UKEF's role to provide certainty of support to exporters and their overseas buyers more relevant than ever.

As measured by the Global Economic Policy Uncertainty (EPU) Index, levels of political uncertainty have remained consistently high throughout 2016. Elections and referendums around the globe have added ambiguity to policy actions, which have been compounded by an increase in the likelihood of protectionist and inward-looking policies. Furthermore, a turbulent geopolitical landscape and underlying succession risk in the Middle East are all likely to have dampened global economic and trade growth.

Global economic policy uncertainty



Source: PolicyUncertainty.com

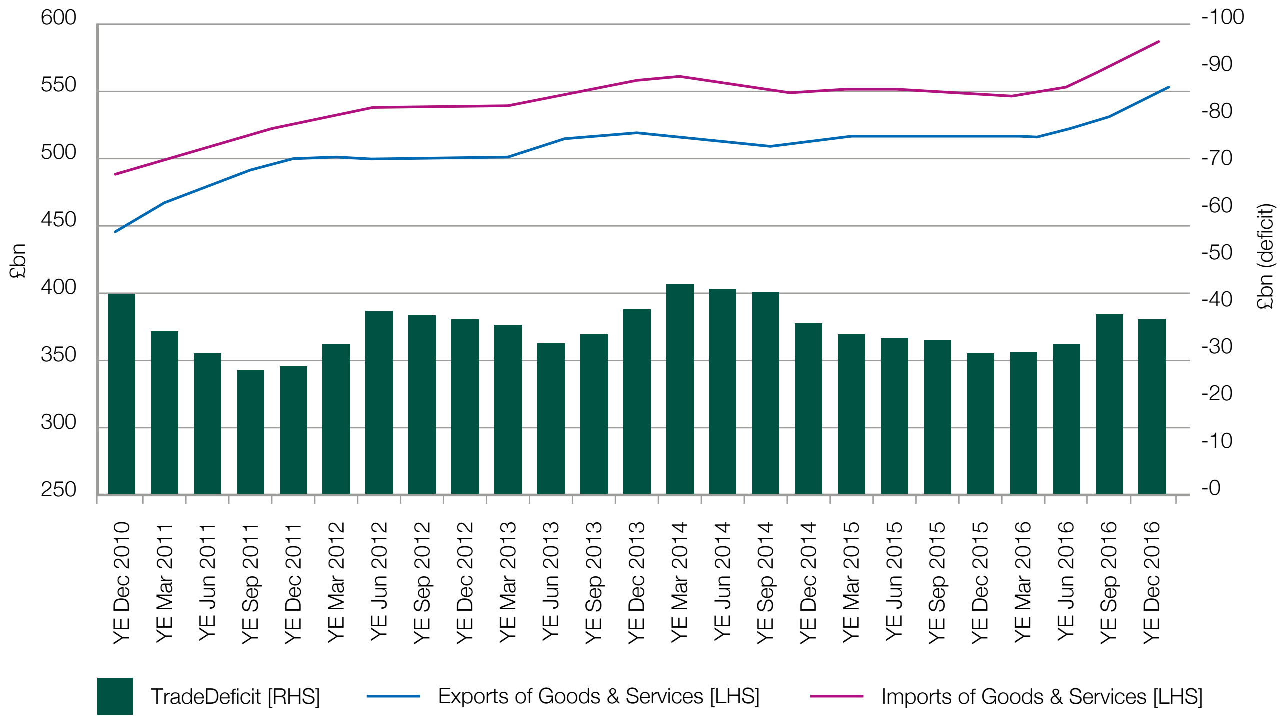
It remains to be seen what policies the US may put in place, and the future relationship between the UK and the EU. Despite these uncertainties, business and consumer confidence remains high, although a continuation of this could be an optimistic view. Nevertheless, UKEF and other export credit agency support could help offset shortfalls in private sector risk appetite.

Domestic factors

UK exports of goods and services increased by 6% from £517 billion in 2015 to £548 billion in 2016. Growth in the exports of goods to the EU was much greater, at around 8%, but exports of goods to non-EU countries rose more modestly at 2%, as goods exports to the US (0.3%) and China (3.2%), our 2 largest non-EU trading partners, increased at a slower rate. Furthermore, there were sharp falls in the exports of goods to some of the bigger emerging market economies – for example, goods exports to recession hit Brazil and India decreased by approximately 10%.

In the aftermath of the UK's vote to leave the EU, the pound depreciated by more than 10% against the US Dollar and the Euro. Looking forward, a weaker sterling is likely to help boost UK exporters' competitiveness.

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



Source: Office for National Statistics

Access to finance

The availability of credit remained higher for large and medium-sized businesses than for small businesses in 2016, although the overall availability to all sizes of business has increased in the last few years. Furthermore, a 2016 survey from the British Business Bank found that credit conditions for smaller businesses improved in 2016, suggesting that access to finance continues to improve for SMEs.

2017-18 outlook

The overall global economic picture over the next couple of years is positive, but with a relatively high degree of uncertainty. Global economic activity is projected to increase by 3.5% in 2017 accelerating moderately to 3.6% in 2018, helped by a cyclical recovery in manufacturing and higher trade in both advanced and emerging market economies. Nonetheless, the balance of risk is tilted towards the downside, considering the potential for disruption of global trade, capital flow reversals and uncertainty over government policy direction in a number of countries. From UKEF's standpoint as a predictable source of competitive support, this environment is likely to lead to increased calls on its risk-taking and financing capacity over the rest of 2017 and beyond.

In 2016-17, 61% of businesses supported by UKEF were manufacturers.

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 the raising of contract bonds on behalf of exporters
- guarantees to banks and investors in the debt capital markets in respect of medium- to 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 (including intangibles) 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 largely determined at any given 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 (for example, the US).

The financial liabilities we assume when supporting exports involve a transfer of risk from the private to public sector (that is, to the UK taxpayer). Direct lending involves upfront public expenditure while other financial liabilities represent contingent public expenditure – that is, taxpayer funding is required only in the event of claims being made under contracts of insurance issued to exporters, or guarantees provided to banks. When claims are made, we instigate appropriate recovery action 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 we 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 seek to create a ‘level playing field’ by setting terms under which export credit agencies can support exports. These agreements emanate principally from the OECD. However, not all export credit agencies 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 arrangements.

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
- 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 as long-term (export credit) and short-term support (trade finance).

Export credit support typically covers exports of capital/semi-capital goods and related services, for example, large projects or high value machinery. Due to the high values involved (normally £5 million to in excess of £1 billion), overseas buyers frequently require loans (usually repayable between 5 and 12 years, or longer) to finance the purchase of such supplies from UK exporters. We provide support under our finance products (such as buyer credit guarantees) 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, for example, consumer durables or light manufactured goods. Such exports are typically sold on short credit terms (up to 1 year), which exposes exporters to (a) risk 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

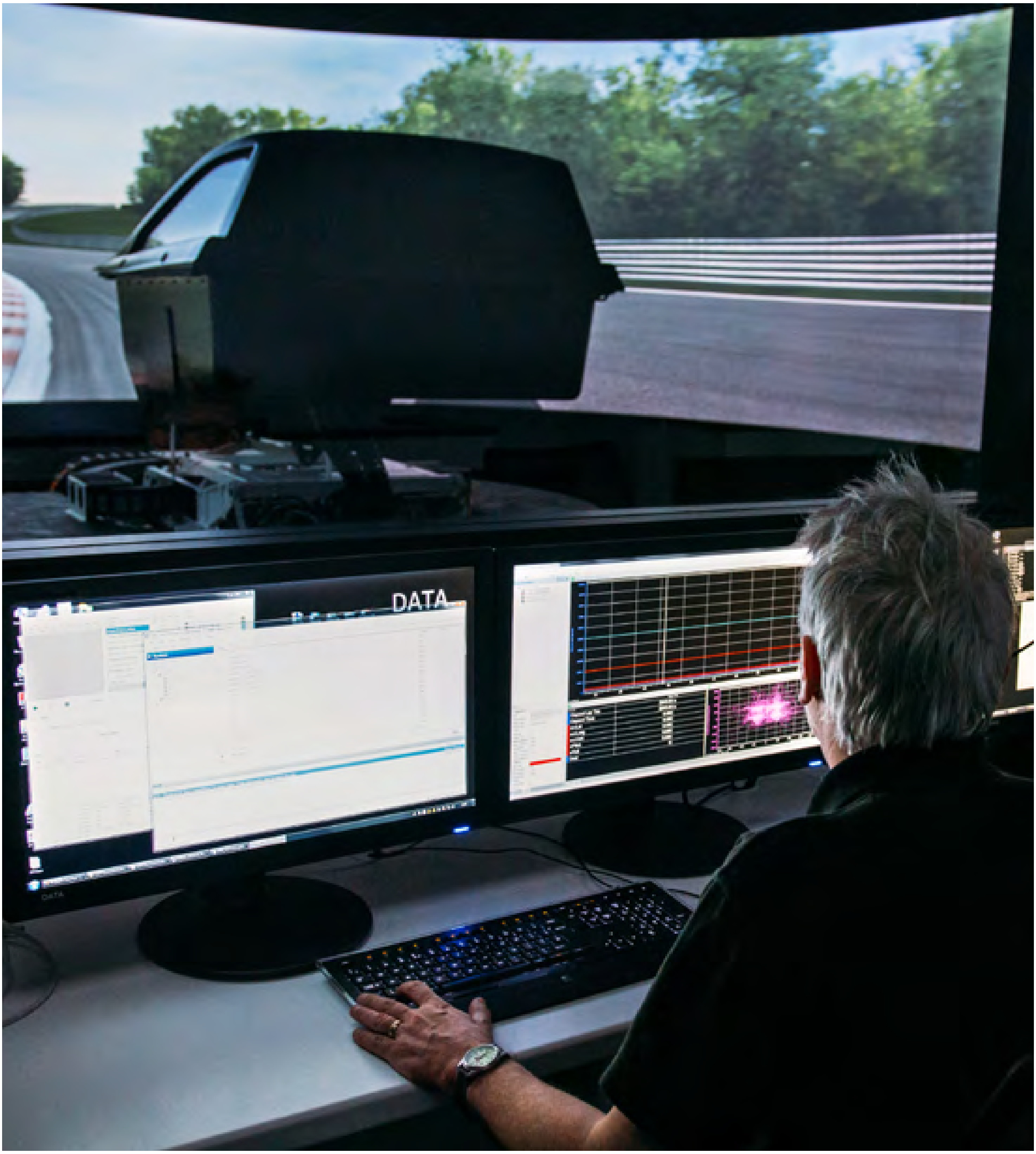
Longer term credit (2 to 18 years)	**Export credit solutions:** supporting finance for overseas buyers of UK exports	• Providing guarantees to banks on the loans they give to overseas buyers to purchase goods and services from the UK • Direct lending to overseas buyers so that they have the funds to 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

Investment

Access to UK Export Finance's products and services provides encouragement for companies to base their international business in UK, supporting foreign direct investment (FDI) in the UK.

We can also support overseas investment by insuring overseas investors against certain political risks, helping to create inward flows of dividends and investment gains to the UK.

We helped Ansible Motion fulfill a major US supply contract for its driver-in-the-loop simulators, shown here in the operations room at the company's base in Hethel, England.



Our support for exports

Business supported	
Exporters supported:	221
Value of support provided:	£3 billion
Destination countries:	63
Largest single facility:	£1.2 billion (buyer credit)
Smallest case:	£9,374 (export insurance)
Most popular product:	Bond support (69 companies)
Highest value product:	Buyer credit guarantees (£2.1 billion)

Focus on trade finance and insurance: making exports happen

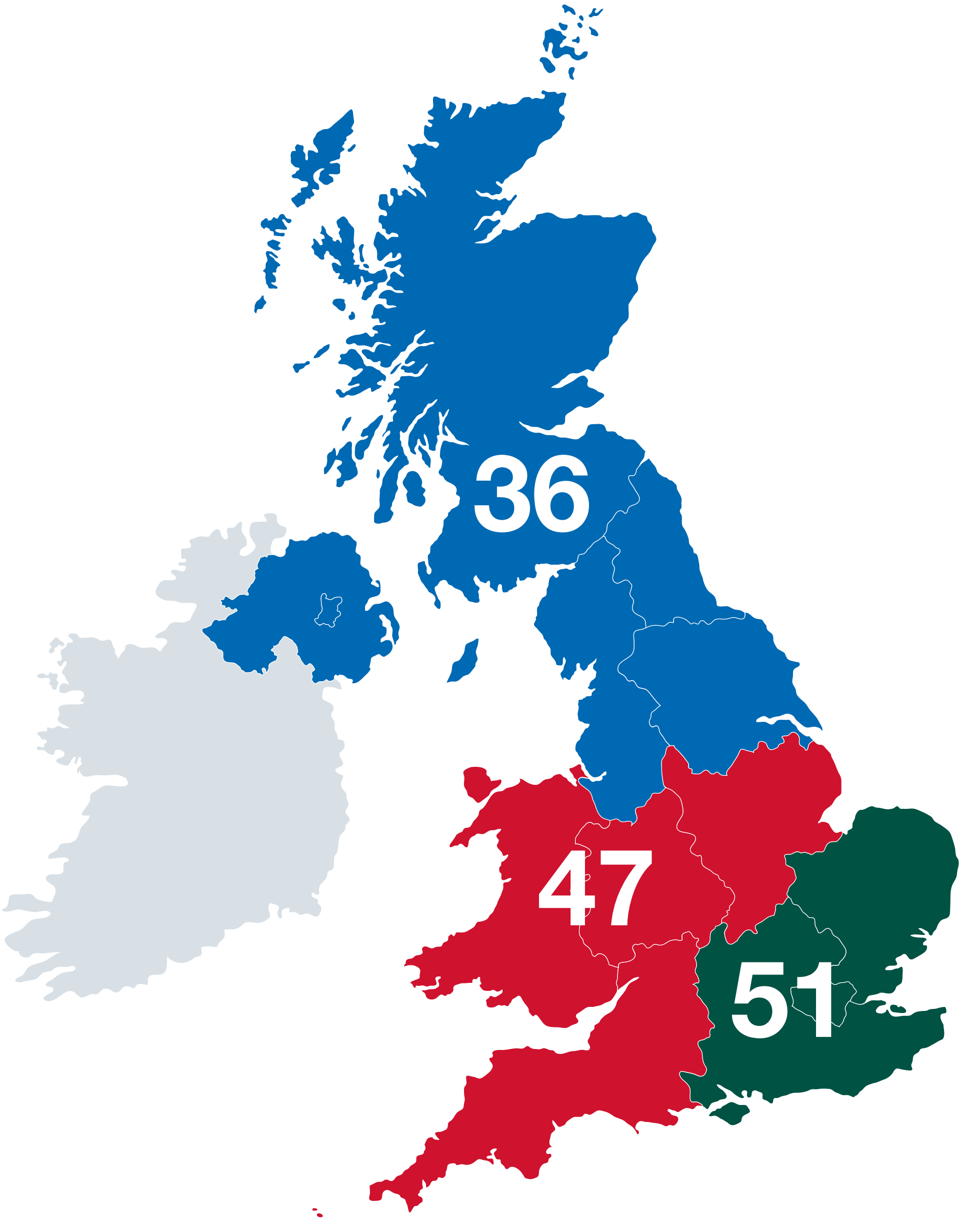
We use our trade finance and insurance support to:

- 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 2016–17 we supported £585 million of export contracts through our trade finance products. We also helped 71 companies find the finance or insurance they needed from the private market.

UKEF has now supported £3.6 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 2016–17



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

They include winners of the Queen's Award for Enterprise. Others have featured in the Sunday Times Fast Track SME Export 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

White Light, a production company from South London, is a great example of how we contribute to business success overseas.

Established in 1971 by a former member of the Rocky Horror Picture Show production crew, White Light began in the theatre industry in London's West End. Over the years it has diversified into exhibitions, sporting events and broadcast.

In 2016 it won a contract with a major theme park in the Middle East with the potential to boost its turnover by 20%. However, under the contract, the buyer required both an advance payment guarantee and a performance bond from White Light's bank, HSBC. Ordinarily, a bank would require a cash deposit in return for these contract bonds. With the size and length of the contract, White Light was not in a position to provide the required collateral, as it would jeopardise cash flow for other areas of growth and the company's ability to fulfil the contract.

We provided a guarantee to the bank for 80% of the bond, freeing up White Light's working capital to undertake the contract. With this success under its belt, further growth in international sales is central to White Light's strategy for the future. It is now exploring opening an office in the Middle East, to focus on winning contracts with major projects in the region.

> "Without the support of UKEF, we would not have been able to undertake this major contract. Working with UKEF will give us confidence that we will be able to realise each opportunity."

Fiona Wood, Finance and Commercial Director, White Light

Protection against non-payment

We helped others to insure against the risk of non-payment when they found cover was unavailable from commercial insurers.

In 2014 Gloucester-based GR Lane, the maker of Olbas Oil, lost its private sector non-payment insurance for its buyer in Greece and had to reduce the amount of business it did. We stepped in to provide export insurance cover, to reduce the risk of the company losing business in an important market. This year sees us continue our relationship with GR Lane, insuring its shipments to Greece for a third year, protecting its 20+ year trade relationships in the country.

> "Greece is an important and steady market for us. We approached UK Export Finance, who helped us to apply for an export insurance policy."

Paul Whatley, Finance Director, GR Lane

Export insurance: top 10 markets in 2016-17
Venezuela
Qatar
Greece
Nigeria
Indonesia
Ukraine
Brazil
United Arab Emirates
South Korea
Algeria

Customer profile: Snowflake Software

Award-winning aviation data software provider, established in 2001, with:

- 30% year-on-year organic growth for the last three years
- sales in the US, Canada, Australia, New Zealand and the Middle East
- recently opened office in Washington DC to support sales in Americas

Snowflake initially specialised in mapping software, and its customers were primarily in the UK; its co-founders, Ian Painter and Eddie Curtis, previously led the technical team responsible for creating OS MasterMap at Ordnance Survey.

Since developing its aviation products, Snowflake has grown rapidly and acquired customers around the world. Its core product – Laminar Data – is the first commercial platform dedicated to managing flight, weather and aeronautical data to support real-time operational applications.

With this growth came finance challenges. When Snowflake won a multi-million pound contract with the UAE General Civil Aviation Authority to provide a bespoke, on-premises solution, the success created funding constraints. Under the terms of the contract, the buyer required a performance bond for 10% of the contract value from Snowflake's bank. In turn, the bank required a cash deposit to issue the bond, which would have restricted the working capital available to fulfil the order and to continue investing in the growth of the business.

UKEF was able to provide a solution. By giving the bank a guarantee under its bond support scheme, it reduced the size of the deposit required, freeing up the cashflow to fulfil the contract.

Lisa Church, Finance Director at Snowflake Software, explains:

> "UKEF's support meant that we were able to release cash back into the business to maintain our focus on delivering a world class product to the customer and expand our business activities elsewhere. With our plans for further international growth, partnering with UKEF in future will give us the confidence that we can continue to realise the opportunities presented by this huge global industry."

Greg Hands, Minister for International Trade, said:

> "Snowflake Software is a highly innovative company with a product for which there is significant global demand, and this government is committed to ensuring that businesses like these can realise the world of opportunity out there. I am delighted that UK Export Finance was on hand to ensure that Snowflake was able to achieve this major export success."

Working capital support

Our ability to support additional working capital has benefited companies like Garrandale, a manufacturer of train carriage wash systems, that attract global demand. The company won a contract to provide wash systems for the North West Rail Link, Australia's first fully-automated rapid transit network.

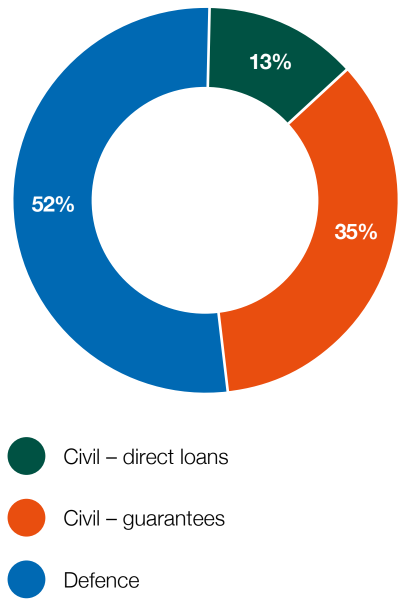
The size of this contract meant the company needed additional working capital to support its cash flow through the long lead times involved in fulfilling the contract. However, when it approached its bank, Santander, it found it was approaching its credit limit.

We provided an 80% guarantee on a working capital loan of £375,000 to finance delivery of the equipment and allow Garrandale to continue investment in other business operations.

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 2016-17

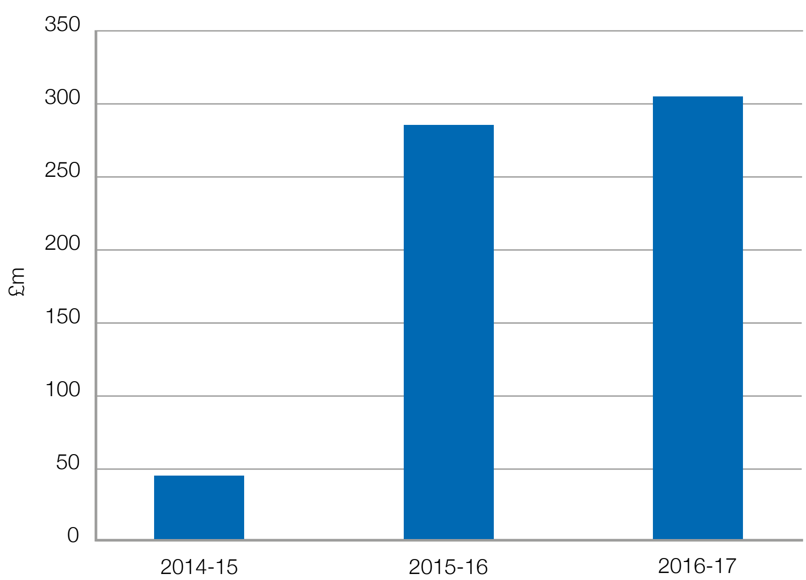


Sector	UKEF maximum liability, £m
Aerospace	7
Civil – direct loans	305
Civil – guarantees	813
Defence	1,227

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 reach £286 million. This year new business increased further to £305 million.

Direct lending



Our largest case was a $310 million direct loan commitment to finance an offshore oil and gas development in Ghana (the ‘Offshore Cape Three Points Project’), with a contract between UK-based GE Oil & Gas and ENI Ghana Exploration. The borrower was Vitol Upstream Ghana Limited, UKEF’s first African borrower. The project will develop gas reserves expected to generate an additional 1,100MW of power for Ghana, which will alleviate the country’s reliance on energy imports, providing long-term energy security and supporting Ghanaian industrial development.

UKEF also supported its first transaction with the Kurdistan Regional Government when it issued a $34 million direct loan to finance Biwater International’s contract to deliver a scoping study for a water and wastewater programme to improve sanitation in the cities of Erbil and Sulaimini.

Buyer loan guarantees

In December 2016, we guaranteed a loan to finance an US$18.7 million contract for GE Caledonian to supply Performance Improvement Program (PIP) kits to 3 GENx engines belonging to the fleet of Atlas Air, a US freight and charter airline. US Ex-Im Bank, the US Export Credit Agency, provided a counter-guarantee to us of US$ 10 million in respect of parts which were sourced from the US. We also agreed a framework with Atlas Air and GE Caledonian to simplify our provision of similar loan guarantees, potentially leading to greater business levels in the future.

We supported a supplier credit facility to Gold Fields Ghana Limited, on behalf of SME exporter Dints International Limited. The line of credit is available for 24 months, during which time monthly drawdowns will be requested to support the ongoing purchase of spare parts from the UK for the maintenance of mining machinery on site.

Two contracts were supported to OPP Film SA of El Salvador, backed by its parent, the Oben Group of Peru. In both cases the exporter was an SME: Bobst Manchester Ltd exported a vacuum metalliser with a contract value of €3.2 million, and Atlas Converting Equipment Ltd exported six slitter rewinders with a value of $4.9 million.

We supported a $2.16 million contract between Nectar Holdings and Seasia of the Philippines for the supply of bulk handling and cargo equipment.

Approximately US$220 million was drawn from the US$500 million line of credit issued to Petrobras in 2015. Petrobras used these funds to purchase UK supplies from Subsea 7 International Contracting. This means the US$500 million line of credit is now fully drawn.

UKEF also supported a US$157 million loan in respect of the Liwa Plastics petrochemical complex in Oman, in relation to supplies from CB&I UK Limited.

Our export credit business included a hat-trick of innovations

1 Tailor-made financing structure

Our support for Dints involved a tailor-made financing structure to support Dints' business model. The company offers customers credit terms alongside aggregated procurement services to provide them with a secure, efficient and cost-effective supply chain under its unique 'vendor managed inventory' concept. UKEF's ability to provide innovative and flexible guarantee support was instrumental in helping Dints win the contract, bringing benefits to its UK supply chain.

2 First direct export credit loan

Our loan to the Kurdistan Regional Government was its first ever direct export credit loan. It will support Biwater's contract to deliver water and wastewater treatment solutions for the cities of Erbil and Sulaimani in the Kurdistan Region of Iraq. The project is designed to alleviate the current strain on existing infrastructure and reduce the region's reliance on dwindling groundwater reserves, delivering long-lasting environmental benefits.

3 New hybrid finance structure

Our support for the Offshore Cape Three Points Project is understood to be the world's first upstream oil and gas development transaction where a European export credit agency has supported a major hybrid finance structure comprising both project finance and reserve-based lending. As the sole ECA, UKEF played a pioneering role in establishing this precedent, reinforcing its growing reputation as one of the world's most innovative and flexible ECAs. The transaction was named Project Finance International's African Oil & Gas Deal of the Year 2016.

Leading with finance

When UKEF provides finance for civil infrastructure projects overseas, it does so on the condition that the finance will be used to purchase UK supplies. A strong finance offer from UKEF can provide the motivation to boost UK participation in the project, giving confidence to buyers, lead contractors and UK suppliers that their efforts will be rewarded. This can lead to a large increase in potential UK suppliers to the projects.

This year we increased our efforts to put UK suppliers in front of the international buyers for projects we have been asked to support.

We organised 2 supply chain fairs around large projects in Egypt and Iraq and their multinational lead contractors. We invited over 300 suppliers to an event to hear about the projects, meet the procurement teams of the lead contractors and hear about the supplier-side support, such as export working capital, that UKEF can provide.

The response to the events was overwhelmingly positive from all parties, with 98% approval ratings from post-event surveys.

Richard Simon-Lewis addresses potential suppliers at a share fair, hosted by UKEF, GE and Enka and supported by EIC and NOF Energy.

Export finance managers: year in numbers

23

Our 23 export finance managers, based across the UK, 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, including from UKEF

73

73 private market assists – when engagement with one of our export finance managers has made 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

406

406 referrals from our export finance managers to services provided by International Trade and Investment, Scottish Enterprise, Business Wales or Invest Northern Ireland

3

3 UKEF staff gained the Institute of Export's Level 5 Diploma in International Trade. All our export finance managers are expected to seek this qualification

2,032

Our export finance managers held 2,032 meetings with intermediaries, for example, banks, brokers, accountants...

2,994

...and they held 2,994 meetings with businesses

1,861

Our export finance managers made 1,861 referrals to other third-party sources of support

Saruq al-Hadid Museum, Dubai was developed and curated by Barker Langham, a consultancy specialising in the planning and development of cultural heritage projects. UKEF has now helped Barker Langham, under its Bond Support Scheme, to facilitate the fulfilment of two further contracts for clients in the UAE. Photo credit: Action Impact.

Our partners and operations

UKEF has a network of partners without which 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.

Partnership examples:

In November 2016 UKEF added the Bank of Ireland to its panel of affiliated lenders for its trade finance support, offering additional support for Northern Ireland's exports

In March 2017 we began trialling referral partnerships with online finance platforms to help more companies find the funding they need

We worked with SACE of Italy and CESCE of Spain to support the sale of Typhoon Aircraft

With the creation of the Department for International Trade, we worked closely with colleagues to become an integral part of the new department's strategy and operations

In March 2017, we joined forces with the Energy Industry Council and NOF Energy to successfully promote our supply chain share fairs to their membership

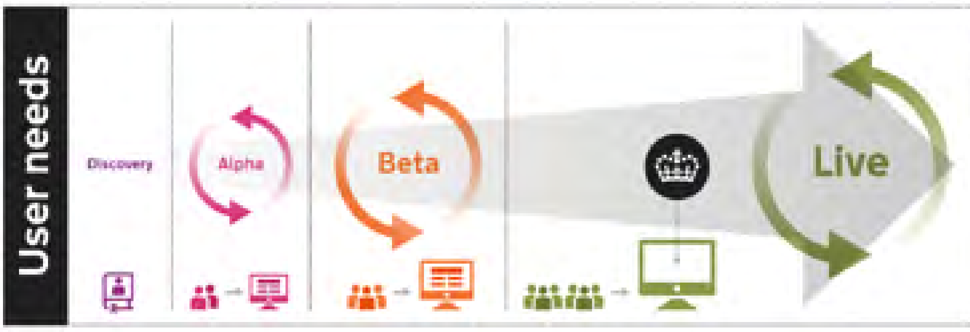
We worked with the ICAEW to produce both a specialist guide to trade finance, and provided expert content for their Business Finance Guide

Operations

This year we made significant investments in IT infrastructure changes, planning and discovery work.

These changes will help us meet agreements we made as part of the 2015 Spending Review to streamline our activities, with savings being reinvested to transform our business processes. The transformation covers 3 broad areas:

- **organisation and workforce:** to bring together functions and rationalise structures, management layers, and processes
- **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
- **service redesign:** focused on working with partners to develop simpler, faster and more scalable service models, built around the needs of the customer



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). Understanding and meeting user needs remains the focus throughout.

Greater Zab River near Erbil, Iraqi Kurdistan
UKEF provided its first direct loan to the Kurdistan Regional Government for the first phase of a water infrastructure development. The project is intended to alleviate the current strain on existing infrastructure and reduce the region's reliance on dwindling groundwater reserves to deliver long-lasting environmental, social and economic benefits.

Chief Risk Officer's report
David Havelock

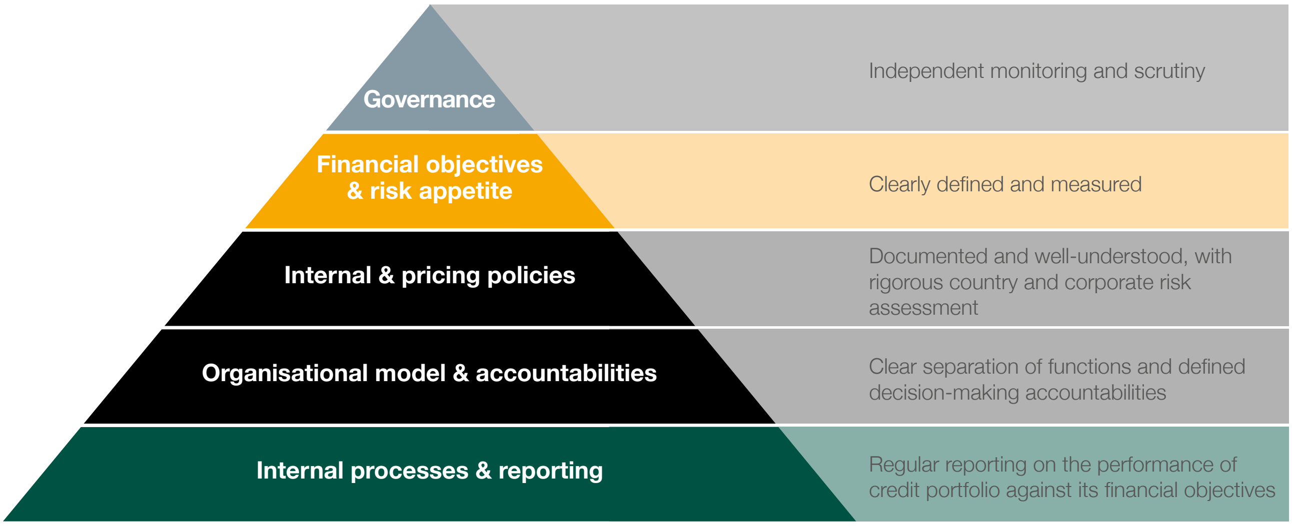
Financial risks

The principal financial risks to which UKEF is exposed are credit, market and liquidity risk:

- **credit risk:** the risk of financial loss if an obligor or counterparty against which we have financial exposure fails to meet its contractual obligations
- **market risk:** the risk of losses due to changing market prices, such as fluctuations in foreign exchange rates and, to a lesser extent, interest rates
- **liquidity risk:** the risk that we do not have the resources to meet our financial obligations when they fall due, or can only do so at excessive cost. However, UKEF's status as a government department enables us to obtain public funds

All of our risk management operations aim to match or exceed the financial services industry's best practice standards. However, given our role as a government-backed export credit agency, the relative importance of different risk types differs from that of the private sector.

Credit risk is the most significant source of financial risk for UKEF. Its management is a core responsibility for the department, which is reflected in our credit risk management framework and operates at every level of the department, as set out below:



Similar principles apply to the other sources of financial risk, although the precise framework varies for each category of risk.

Credit risk management

Context

Parliament sets an overall limit, equivalent to SDR67.7 billion[5], 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 the risk we take on.

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

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

Credit risk governance

As Accounting Officer, the ultimate responsibility for credit risk management within UKEF lies with the Chief Executive, 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 UKEF's risk management activities are also subject to independent monitoring and scrutiny.

The UKEF Board provides independent advice, scrutiny and challenge to the Chief Executive across a broad range of areas, including risk management.

A subcommittee of non-executive directors makes up the Audit & Risk Committee, which separately reviews the adequacy of risk management and controls across the department. Meetings of the Audit & Risk Committee, typically held five times a year, are further attended by a National Audit Office official.

To accommodate UKEF's recent increase in risk appetite, as agreed by HM Treasury and the Board, an enhanced reporting framework has been introduced involving the Audit & Risk Committee becoming two separate committees, Audit and Risk – see 125 and 126.

HM Treasury officials monitor the department's performance against its financial objectives. 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 effectively managed, and provides advice to the Secretary of State on the exercise of ministerial responsibility for UKEF.

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5 Special drawing rights are an international reserve asset, created by the IMF. Their value is based on a basket of five major currencies—the US dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling.

Within UKEF, the Credit Committee is responsible for advising the Chief Executive on the effective management of UKEF's credit risk exposures. Its responsibilities include:

- approving, managing and monitoring credit risk exposures at the transaction and portfolio level
- agreeing credit risk policies
- ensuring that credit risks are properly monitored and controlled through UKEF's processes and systems

It is scheduled to meet fortnightly, if required, but can be convened on an ad hoc basis to consider urgent business. The standing members of the Credit Committee are:

- Chief Executive Officer
- Chief Risk Officer
- Chief Financial Officer
- Head of Business Group
- Deputy Director of Risk Assessment Division
- Deputy Director of Country Risk and Analysis Division
- Head of Pricing and Portfolio Risk Unit

The Head of Legal Division or a nominee will also attend to provide advice on legal matters.

For a meeting to take place, at least 3 standing members of the committee must be present. At least one of the following must attend every meeting:

- Chief Risk Officer
- Deputy Director of Risk Assessment Division
- Deputy Director of Country Risk and Analysis Division

Further, either the Chief Executive or Chief Financial Officer must also attend every meeting. Overall, at least 3 standing members must be present. In the absence of the Chief Executive, a unanimous decision of standing members, including the Chief Financial Officer, must be obtained for any approvals.

Financial objectives and appetite

UKEF's financial objectives are designed to enable it to fulfil its risk-taking mandate while ensuring that such risk a) is undertaken on a basis that adequately rewards UKEF for the risks it is assuming and b) does not expose the taxpayer to the risk of excessive loss.

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

- **maximum commitment:** the maximum amount of nominal credit risk exposure that the department may incur. Set at £50 billion but adjusted for foreign exchange movements (for example, at 31 March 2017 the adjusted maximum commitment was £62.9 billion)
- **risk appetite limit:** a form of economic capital limit of £5 billion (detailed further in the next section)
- **the exposure management framework:** a limit to exposure of £5 billion for the lowest risk markets, with reducing capacity as the risk profile increases (detailed further in the section on our Exposure Management Framework on page 72).

A significant change this year was the increase to our maximum country and risk appetite limits agreed by ministers and HM Treasury. This was done in conjunction with:

- the agreement of a revised 'active portfolio management' policy framework whereby UKEF can use the private reinsurance market to offset significant portfolio risks
- the quadrupling, from 10 to 40, of the number of local currencies in which UKEF can offer guarantees on loans to overseas buyers

Further financial objectives linked to HM Treasury consent are the 'reserve index', the 'pricing adequacy index' and the 'premium-to-risk ratio'.

The reserve index measures whether UKEF has accumulated, over time, sufficient revenue to cover possible credit losses at the 77.5 percentile on our 10-year loss distribution.[6] The pricing adequacy index and the premium-to-risk ratio are detailed under 'Pricing policies' on page 77.

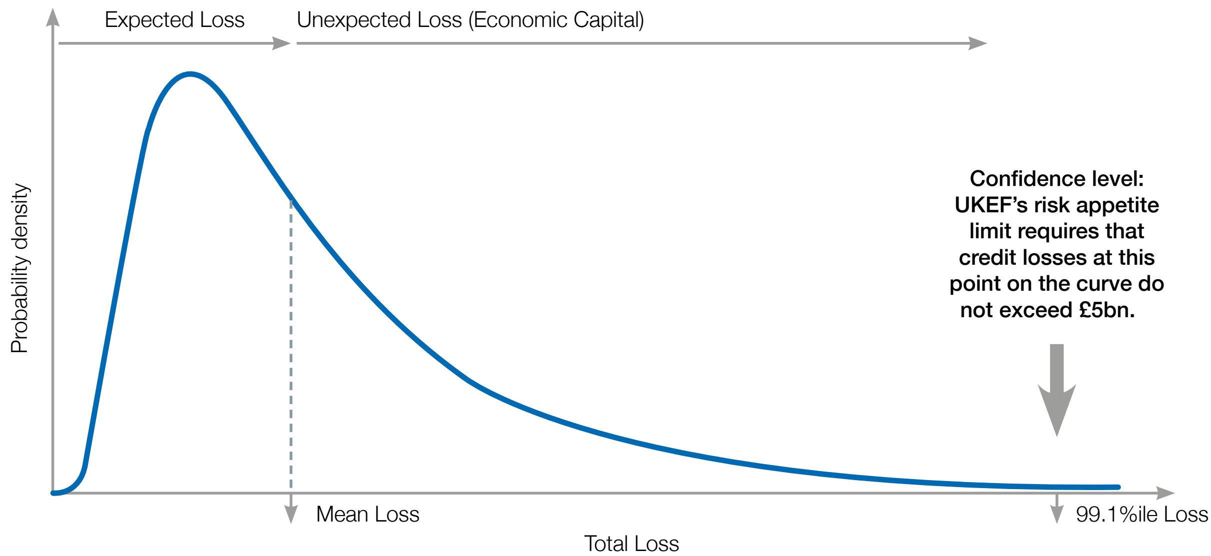
The 2016–17 outturn against all our financial objectives is presented on page 36.

6 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 our 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 potential future losses. It can be considered as the buffer required to cover losses over a defined future period 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 a defined time period. Expected losses essentially represent a 'cost of doing business', implying that when a financial institution assumes credit risk, it should always seek to charge an amount at least sufficient to cover the expected loss associated with the relevant loan, guarantee or insurance policy.

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, 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 a theoretical measure for UKEF risk management purposes, since if we did incur losses, these would be ultimately underwritten by public funds.)

Unexpected loss recognises the potential for actual losses to exceed expected losses, reflecting 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, using 10-year time horizon will not (with a 99.1% degree of certainty) exceed £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 £5 billion (adjusted for foreign exchange movements).

Portfolio expected loss
+ Provisions
+ Portfolio unexpected loss
≤ £5 billion

The credit risk policy, the pricing methodology and the exposure management framework are the main policies that apply to the management of credit risk within UKEF. All policies are reviewed (at least) annually by the Credit Committee and endorsed by Audit & Risk Committee.

Credit risk policy

This sets out the high-level policies and processes used for assessing, measuring, managing and reporting all categories of credit risk to which UKEF is exposed. It establishes minimum risk standards and ratings-based exposure caps.[7] A series of more detailed risk management policies, frameworks and individual risk methodologies sit below the credit risk policy.

Pricing methodology

This sets out 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)[8] 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

We assume credit risk in a large number of countries as we support UK export transactions. Our exposure management framework sets individual country limits based on the following key principles:

- countries with higher levels of credit risk, based on individual country reviews on a ratings-based approach, will tend to have lower limits

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7 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

8 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.

- the larger a country's economy (as measured by its GDP), the higher the country limit tends to be
- country limits should be set relative to the notional financial resources available to UKEF and consistent with UKEF meeting its financial objectives
- the upper boundary for exposure to any individual country is £5 billion

The Credit Committee regularly reviews country limits and cover policies. In addition, it sets individual controls on a case-by-case basis within each country limit. Risk and cover policy must be assessed and approved for around 200 markets, but priority is given to active new business requirements and existing exposures.

Country risk assessment

We rank each country in which we have an actual or potential credit exposure and use this to produce a credit rating, from AAA (highest) to D (default, lowest). Our risk assessment framework is aligned with that used by Standard & Poor's (S&P), but is additionally informed by cross-Whitehall forums, local UK diplomatic representatives, quarterly OECD country risk expert meetings, and country visits, where appropriate.

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.

Corporate, bank and project finance risk assessment

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 its credit rating templates to cover our principal areas of business (general corporates, airlines, banks and project finance). These are annually updated and approved by the Credit Committee.

The rapid expansion of our trade finance business, which typically involves SMEs and relatively small individual credit risk exposures, has led us to purpose-build a number of credit assessment methodologies with shorter-turnaround times for certain categories of risk. For example, a specific credit assessment and approval process has been adopted for our bond support and export working capital facilities, under which UKEF shares risks with financial institutions for the provision of working capital loans and on-demand contract bonds in support of export transactions. This process is to be further enhanced in 2017–18 as we agree a delegated authority for financial institutions to apply our guarantee quickly and flexibly.

Similarly, a bespoke credit assessment process has been developed to handle the payment risks that arise under our export insurance, and the credit and political risks covered by our bond insurance.

UKEF's credit risk methodologies

Product category	Product	Description	Credit risk party	Credit risk methodology
Credit insurance	Export insurance policy (EXIP)	Covers risk of non-payment under an export contract due to specified commercial and political risks	Overseas buyer	Bespoke UKEF methodology
	Bond insurance policy	Covers unfair calling of contract bonds, or fair calling due to specified political events	Overseas buyer	Bespoke UKEF methodology
Loan/capital market guarantees	Buyer credit	Guarantees medium/long-term finance from lenders or capital market investors provided to overseas buyers of UK goods/services	Overseas buyer	Bespoke UKEF country risk methodology S&P rating methodologies
	Supplier credit			
	Lines of credit			
	Export refinancing facility	Add-on to buyer credit, securing the availability of long-term funding	Overseas buyer	
Trade finance	Bond support scheme	Guarantees contract bonds	UK exporter	Bespoke UKEF methodology
	Export working capital scheme	Guarantees working capital loans provided by private lenders to UK exporters	UK exporter	Bespoke UKEF methodology
	Letter of credit guarantee scheme	Guarantees for 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 from UKEF to overseas buyers of UK goods/services	Overseas buyer	Bespoke UKEF country risk methodology S&P rating methodologies
Investment insurance	Overseas investment insurance	Insures overseas assets of UK exporters against specified political risks	Overseas buyer and its sovereign	Bespoke UKEF 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 UKEF to hedge interest rate exposure under its legacy fixed-rate export financing scheme, which closed to new business in 2011 (see page 91). UKEF has the right to terminate these trades if a counterparty's rating falls below a specified credit rating threshold.

Credit risk assessment outputs

Expected loss is a key measure of credit risk at UKEF and is central to our pricing methodologies and our underwriting fund accounting. Our credit risk assessments are used to indicate the three components of expected loss:

- Probability of default
- Loss given default
- Exposure at default

Credit risk assessments are used to assign all credit risks within UKEF a rating (from AAA to D) each with an associated probability of default. The probabilities are updated at least annually in line with the latest S&P statistics.

Our credit risk assessments also provide an estimate of loss given default: how much we stand to lose if an obligor defaults, expressed as a percentage. Corporate loss given default assessments are conducted on a case-by-case basis, considering the specifics of the transaction in question, including security, priority ranking, and likelihood of restructuring, sale or liquidation. In the absence of a bespoke calculation, UKEF's standard corporate loss given default assumption is 50%.

In the case of sovereign risk, persistence of default is also included in the calculation of potential loss. Based on empirical research, persistence of default (the predicted duration of a country's default) is calculated as a function of its per capita income, the severity of its indebtedness and whether the default is a liquidity event or an insolvency.

The third output of our assessments is exposure at default, meaning the credit risk exposure we have at the time of default.

The other measure of credit risk we monitor closely is unexpected loss, which is integral to our credit risk appetite. Unexpected loss is the difference between the 99.1% value of UKEF's credit portfolio loss distribution, and the portfolio expected loss (see 'Economic capital and the risk appetite limit' on page 71 for further explanation). Unexpected loss is expected to increase if a credit portfolio has high risk concentrations and/or if the risks themselves are highly correlated. We give particular consideration to risk concentration and correlations due to the nature of our business compared with the more diversified credit portfolios typical of private sector financial institutions.

Risk concentration and correlation

Given its role, it is almost inevitable that UKEF's credit portfolio will have risk concentrations. Consequently, portfolio modelling (particularly 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 group of related obligors.

For any given case, our modelling will seek to account for the likely correlations between all risks in the portfolio to determine a case's impact on portfolio unexpected loss. Only if the Credit Committee is satisfied that a case's level of credit exposure will not threaten any of UKEF's financial objectives in light of this modelling 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. In addition:

- all individual exposures within a country must not exceed the maximum country limit, as established under our Exposure Management Framework
- no single commitment in excess of £200 million may be given by UKEF without the agreement of HM Treasury
- the portfolio is further managed by way of review points for single obligor, sector and regional/geographic concentration risk

One practical means of reducing risk concentration at the 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.

While UKEF has used credit default swaps (subject to a value-for-money basis) in the past, more recently UKEF has approached the private insurance market, which has appetite for risk sharing on medium- to long-term exposures, to manage large exposures.

Stress testing and scenario analysis

It is UKEF policy to undertake extensive stress testing of its credit portfolio. Stress testing assesses the impact of various adverse scenarios and is conducted every 6 months.

These scenarios are designed to reflect potential emerging risks and may vary from one exercise to the next, but may include for example a general emerging markets crisis or an extended period of very low oil prices. They generally involve simulating:

- rating downgrades
- increases in losses given defaults
- a series of large individual defaults

The Credit Committee reviews the results of the analysis, and in particular considers the potential impacts on the value of the 99.1% percentile on the portfolio loss distribution, relative to the risk appetite limit of £5 billion.

UKEF uses its own portfolio risk management simulation model, and its associated correlation matrix, to undertake all 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. This analysis is valuable for informing cash flow forecast and liquidity management purposes, for both UKEF and HM Treasury.

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 that are sufficient to cover their long-term operating costs and credit losses. This mirrors the provisions of the WTO Agreement on Subsidies and Countervailing Measures, which classifies export credit guarantee programmes that do not cover their long-term operating costs and losses as 'prohibited subsidies'.

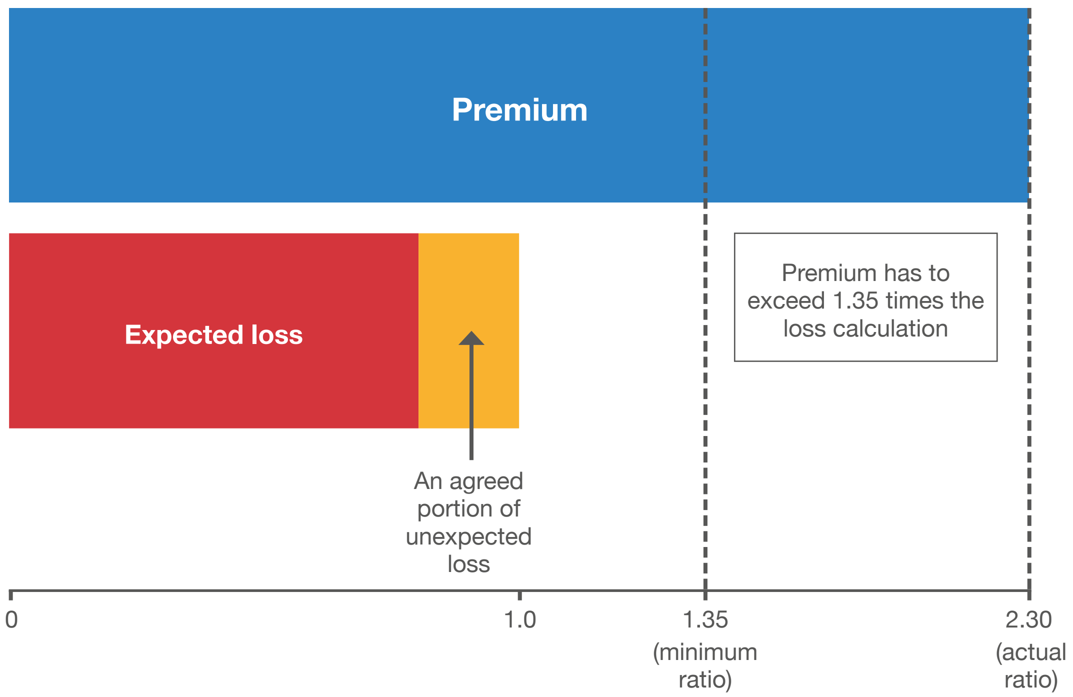
Financial objectives

Consistent with these principles, HM Treasury has set 2 financial objectives for UKEF designed to ensure, as far as possible, that the premium rates we charge reflect the risk taken on, and are sufficient for us to operate at no net cost to the taxpayer over time.

Premium-to-risk ratio

Firstly, the premium-to-risk ratio states that we must demonstrate each month that the premium charged on the business issued or forecast to be issued in the financial year will be 1.35 times greater than an agreed level of possible losses corresponding to those transactions as measured at the time of pricing.

The ratio at 31 March 2017 was 2.30 against the 1.35 ratio minimum.

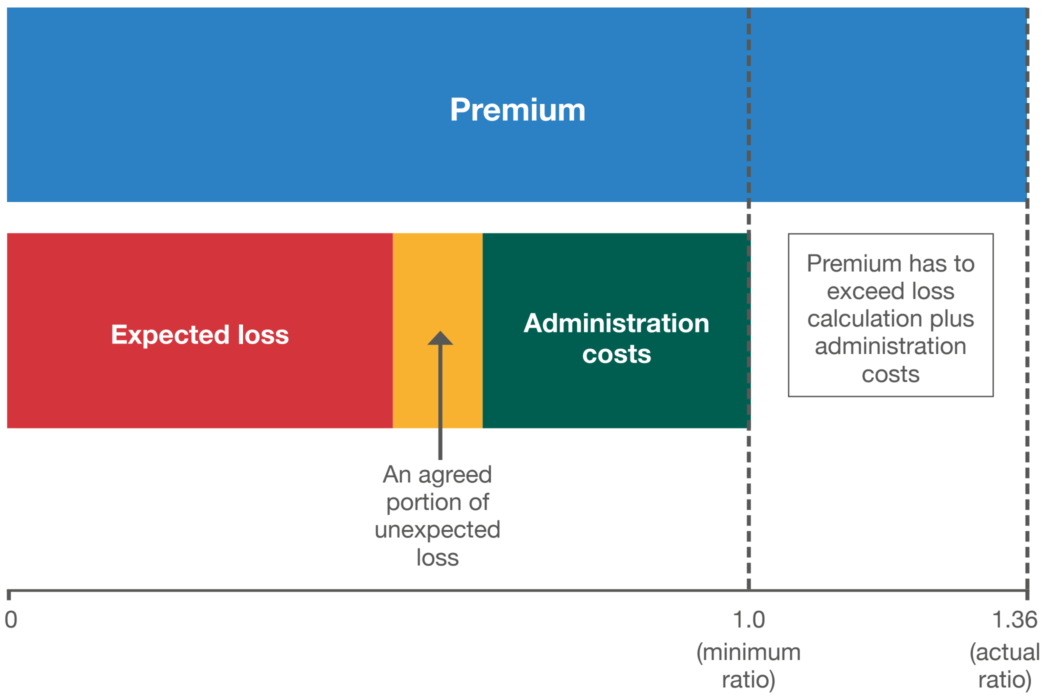


Pricing adequacy index

The second objective set out by HM Treasury is the pricing adequacy index. Whereas the premium-to-risk ratio serves purely as an annual measure, the pricing adequacy index considers a three-year time scale, applied across three accounting periods:

- the 2 previous and the present financial year
- the previous, current and next financial years
- the present and the next 2 financial years

For each period, UKEF must demonstrate that the actual plus forecast premium will cover and exceed the 'cost of doing business', meaning administration costs and an agreed level of possible losses. The ratio for the past 2 years and present financial year was 1.36 against the minimum of 1.0:



Forecasting approach

Business and premium 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 current or future financial years. In addition, we perform regular sensitivity analysis to supplement these 'central' forecasts and to test the robustness of forecast financial performance against the agreed premium-to-risk ratio and pricing adequacy index targets.

Pricing methodology

We set risk-based premium rates for all of our products using pricing methodologies and parameters that are reviewed annually by the Credit Committee, endorsed by Audit & Risk Committee and agreed by HM Treasury.

UKEF aims to support UK exporter competitiveness and as such, it is our policy that we set the lowest achievable premium rates, subject to the following:

- premium rates may not 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 satisfy the premium-to-risk ratio and pricing adequacy index financial objectives
- premium rates set for OECD countries without fixed benchmarks (Category 0 'rich' countries) should not undercut available market pricing[9]
- premium rates must comply with our international obligations, including 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 vital and appropriate checks and balances in the credit approval and credit management processes.

Within the Credit Risk Group, there is a framework of delegated credit authorities:

- the Chief Risk Officer has been given authority by the Chief Executive to approve various categories of credit risk within pre-determined limits
- in turn, the Chief Risk Officer has granted authority over certain credit approvals to senior staff within his team
- credit approvals that exceed the delegated authority of the Chief Risk Officer must be approved by the Credit Committee

Credit processes and reporting

All material credit risks must be approved by the Credit Committee or a designated member of the Credit Risk Group with the appropriate delegated authority. Once approved, credit exposures are continuously monitored and reviewed at both portfolio and individual transaction level.

9 In the last year, the OECD has agreed new minimum premium rate rules for these markets to ensure consistency in pricing among participating ECAs.

The Credit Committee oversees portfolio-level monitoring. This includes stress testing and scenario analysis every six months, and a monthly review of portfolio movements, particularly focusing on exposure, expected loss and unexpected loss changes. The 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 regularly update the ratings allocated to 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 of a non-sovereign borrower deteriorates such that UKEF might expect to pay out under a guarantee or insurance policy, the case will henceforth be managed by a dedicated claims and recoveries unit.

The claims and recoveries unit

This year saw the transfer of the claims and recoveries unit to the Credit Risk Group. The unit submits regular reports to the Credit Committee on all accounts it is responsible for and seeks approval for its recovery actions. Once claims have been paid, the unit makes provisioning recommendations to the Credit Committee on a case-by-case basis, with a full provisioning exercise conducted at the end of each financial year.

Sovereign defaults that lead to debt renegotiations through the Paris Club[10] are managed by a team within the Finance Group that specialises in such re-scheduling, working in conjunction with HM Treasury.[11] Paris Club developments are monitored by the Credit Committee, which must approve any provisions made against this exposure.

The process of recovery through Paris Club re-scheduling is often a protracted one; a number of still-active re-schedulings relate to exposure incurred prior to April 1991.

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10 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.

11 The majority of the UKEF portfolio is denominated in USD and the exchange rate to GBP moved from 1.44 on 31 March 2016 to 1.25 on 31 March 2017.

Credit risk performance 2016-17

Context

Our credit portfolio is dominated by long-dated emerging market risk, consistent with our role as the UK's official export credit agency. We are limited in our control over the geographic or sectoral composition of our portfolio, as we assume credit exposure in line with the needs of UK exporters, rather than through the pursuit of a well-balanced portfolio.

Consequently, it is expected that our credit portfolio, like those of other export credit agencies, will have higher risk concentrations than typically seen in private sector financial institutions. Our financial objectives set by HM Treasury take account of these factors.

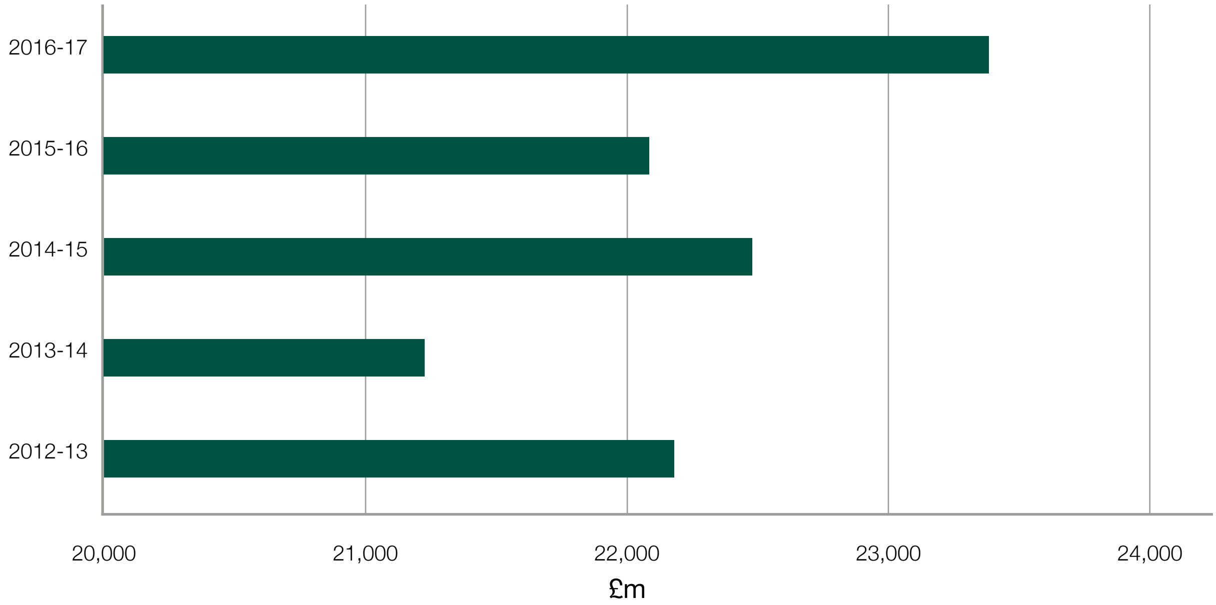
In 2016–17, we again demonstrated full compliance with all of our financial objectives relevant to the credit portfolio. A full summary of performance against financial objectives is reported on page 36.

The UKEF credit risk portfolio: 12-month summary

- total exposure increased to £23.4 billion, up from £22.1 billion, as new business issued and significant foreign exchange movements for dollar exposures exceeded business run-off[12]
- the portfolio remained resilient to even extreme stress testing
- portfolio credit quality remained stable, with 49% investment grade (net of reinsurance) and 51% of sub-investment grade exposure being asset-backed
- stable economic and sector outlooks, with fewer downgrades in our portfolio
- the potential for oil price volatility remains a risk factor given current sector exposure and pipeline forecasts, but this is mitigated somewhat by higher price forecasts than assumed last year. The portfolio remains resilient to anything less than an extreme price fall from current levels for an extended period
- stable expected and unexpected loss rates with continuing very low rate of claims paid at £8.8 million (of which £0.5 million were for new defaults this year)
- increased risk appetite in 27 countries (with more to come in 2017–18) on a risk-related scale as the maximum country limit was increased from £2.5 billion to £5 billion

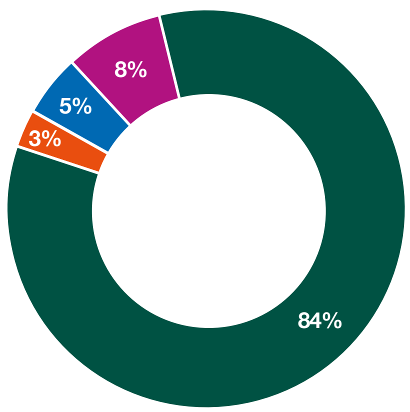
12 The majority of the UKEF portfolio is denominated in USD and the GBP to USD exchange rate moved from 1.44 on 31 March 2016 to 1.25 on 31 March 2017.

Credit risk exposure (£m)

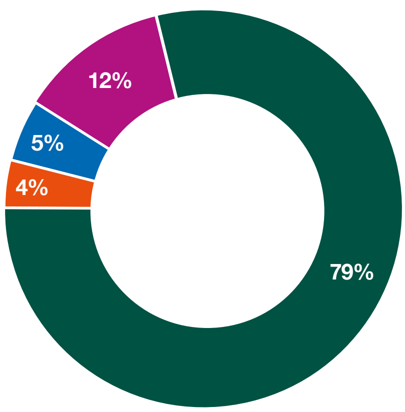


The charts below show the breakdown of this exposure between amount at risk (AAR)[13], claims (both principal and interest) and commitments.[14]

Breakdown of total exposure, 31 March 2017



Breakdown of total exposure, 31 March 2016



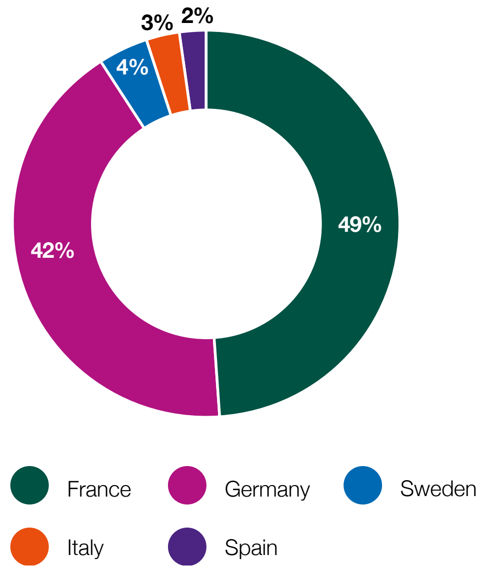
AAR
Commitments
Claims interest
Claims principal

13 AAR is equivalent to Contingent Liability in accounting and 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.

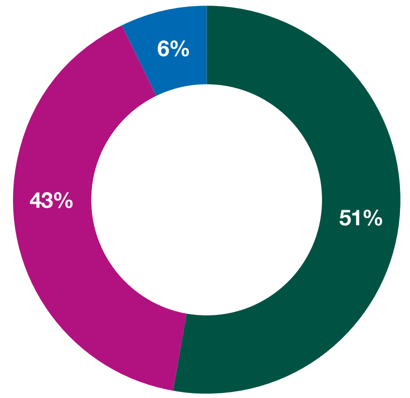
14 Commitments are cases not yet the subject of an issued guarantee, but for which UKEF has communicated its intention, before a specified date and subject to conditions, to provide support.

At 31 March 2017, total AAR amounted to £18.9 billion (£17.1 billion in 2016). This figure includes £6.0 billion (£5.5 billion in 2015) of counter-guarantees provided to UKEF by other European ECAs, principally related to Airbus business.

Breakdown of export credit agency counter-guarantees, 31 March 2017



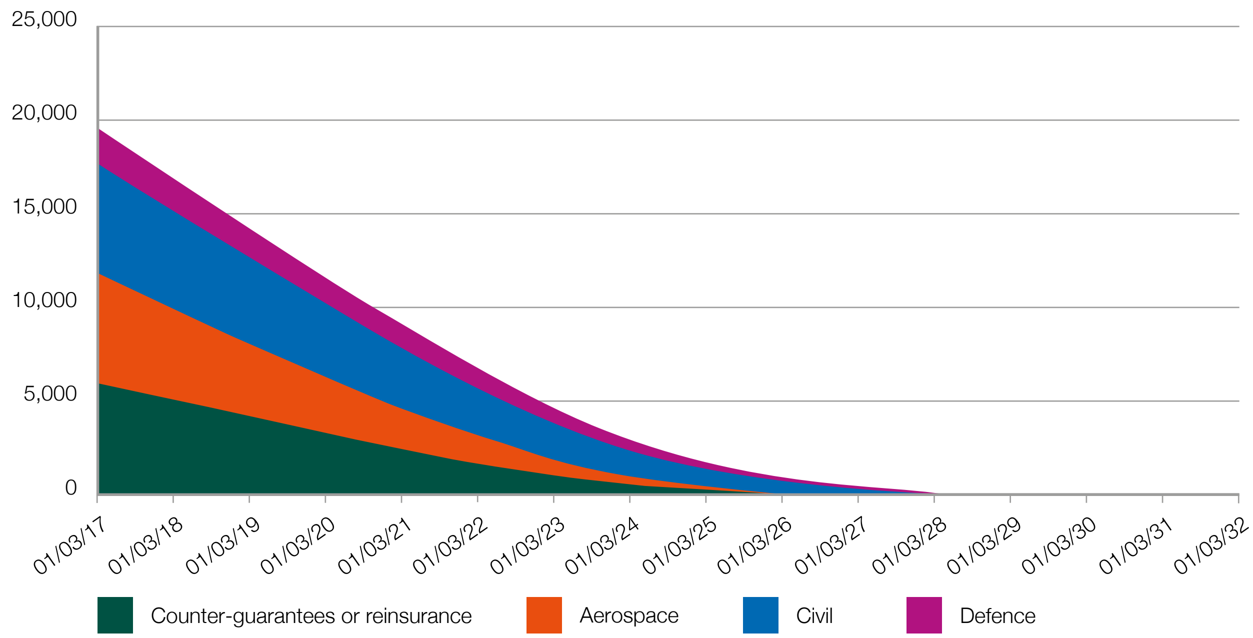
Breakdown of export credit agency counter-guarantees, 31 March 2016



Horizon of risk

The vast majority of our credit exposure is made up by medium- to long-term finance. The chart below illustrates how our current portfolio is expected to run off over time in terms of overall AAR. Over the next 12 months, around 14% will run off, with around 54% of the current portfolio having expired within 4 years.

Amount at risk run-off (£m)



Exposure by product

The table below breaks down the AAR by product sector, excluding export credit agency reinsurance. Within the last year, the most notable changes have related to our civil aerospace and corporate credit exposure:

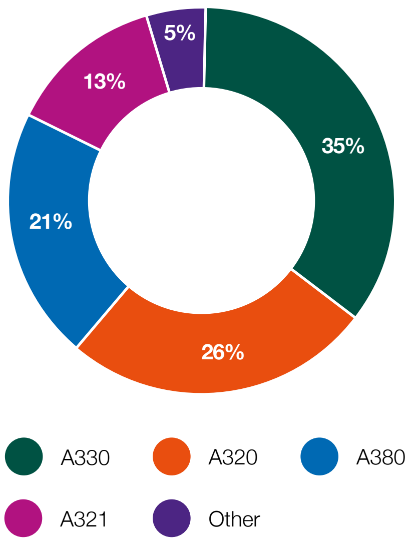
- civil aerospace exposure decreased from 53% to 42% of overall AAR, due to the lack of new aerospace business
- sovereign credit exposure increased from 7.4% to 14.7%, due to a number of large new cases
- direct lending continues to increase as a proportion of overall exposure, with more transactions being issued in the third year of this facility

Product sector	31 March 2017		31 March 2016	
Civil aerospace	5,737	42.4%	6,346	52.9%
Corporate credit	3,036	22.5%	2,347	19.6%
Sovereign credit	1,985	14.7%	888	7.4%
Project finance	1,396	10.3%	1,113	9.3%
Direct lending	687	5.1%	339	2.8%
Export insurance	243	1.8%	522	4.3%
Bond support	188	1.4%	177	1.6%
Bank	177	1.3%	195	1.6%
Bond insurance	41	0.3%	41	0.3%
Other	24	0.2%	26	0.2%
Total	**13,515**	**100%**	**11,994**	**100%**

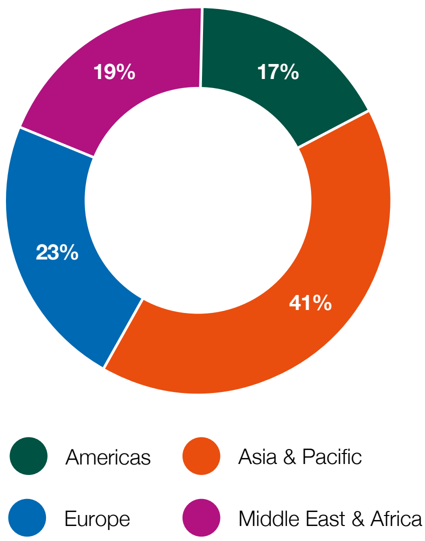
Risk concentrations: sectors

UKEF's largest risk concentration remains in aerospace, accounting for 42% of the AAR (net of export credit agency reinsurance/counter-guarantees) as at 31 March 2017 (53% for 2016). However, our aerospace portfolio is well diversified across airlines and aircraft-leasing companies, and by aircraft type and geographical region, as detailed below.

Aerospace portfolio by aircraft type



Aerospace portfolio by geography



All aerospace exposure is secured on the underlying aircraft.[15] Accounting for the value of this asset security, UKEF's net exposure to the sector is much lower at £249 million (£306 million in 2016).

At 31 March 2017, UKEF had £1.8 billion credit exposure (AAR) to the oil and gas sector, representing 14% of our overall AAR (net of export credit agency reinsurance/counter-guarantees), mainly across South America, Eastern Europe and Asia.

Other sectoral concentrations were to the chemicals industry (£1.4 billion AAR), spread across the Middle East and Asia, and to the commercial real estate sector (£1.6 billion AAR), again, mainly in the Middle East and Asia.

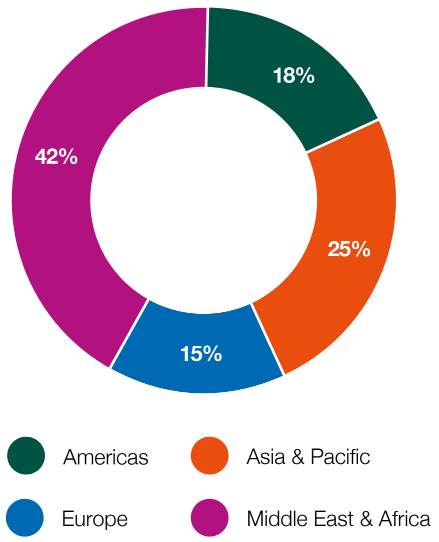
Risk concentrations: geography

As of 31 March 2017, the Middle East and Africa accounted for 42% of our net portfolio. The majority of this resulted from the support of UK exports to Ghana, Oman, Saudi Arabia, and the United Arab Emirates.

15 This means that UKEF can take possession of aircraft from defaulting airlines. Following the 9/11 terrorist attacks, 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.

Asia accounted for 25% of net AAR, of which around £2.4 billion was attributable to civil aerospace business across a number of airlines. In the Americas, around £1 billion of exposure was attributable to the aerospace sector, with much of the non-aerospace exposure centred on Brazil.

Regional breakdown of net AAR – whole porfolio



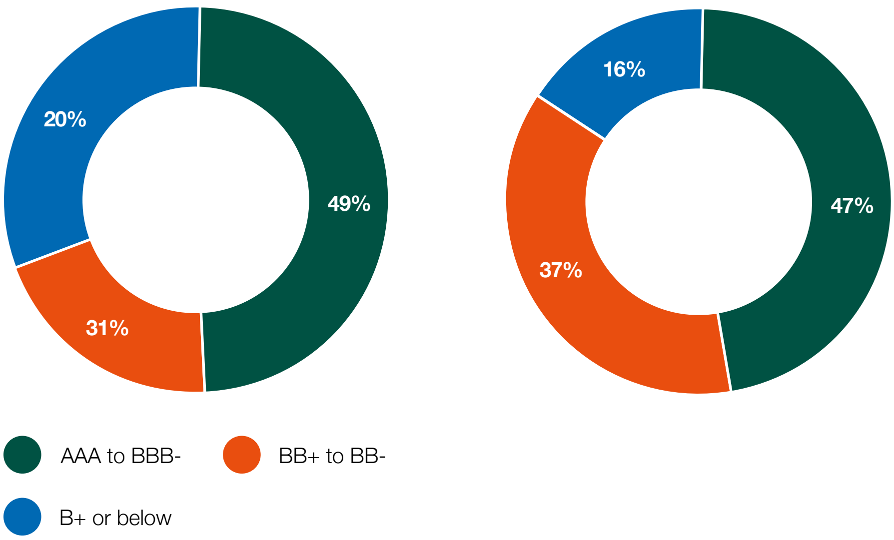
Global AAR at 31 March 2017: darker shading indicates higher AAR

Credit quality

The credit risk quality of our portfolio remained stable in 2016–17.

As at 31 March 2017, 49% of AAR (net of reinsurance) was rated 'investment grade' by UKEF (compared to 47% in 2016). As compared to 2016, the stable economic and sector environment led to fewer downgrades affecting the portfolio. This is consistent with rating agencies views also having improved for corporates.

Net AAR by ratings, 31 March 2017 **Net AAR by ratings, 31 March 2016**



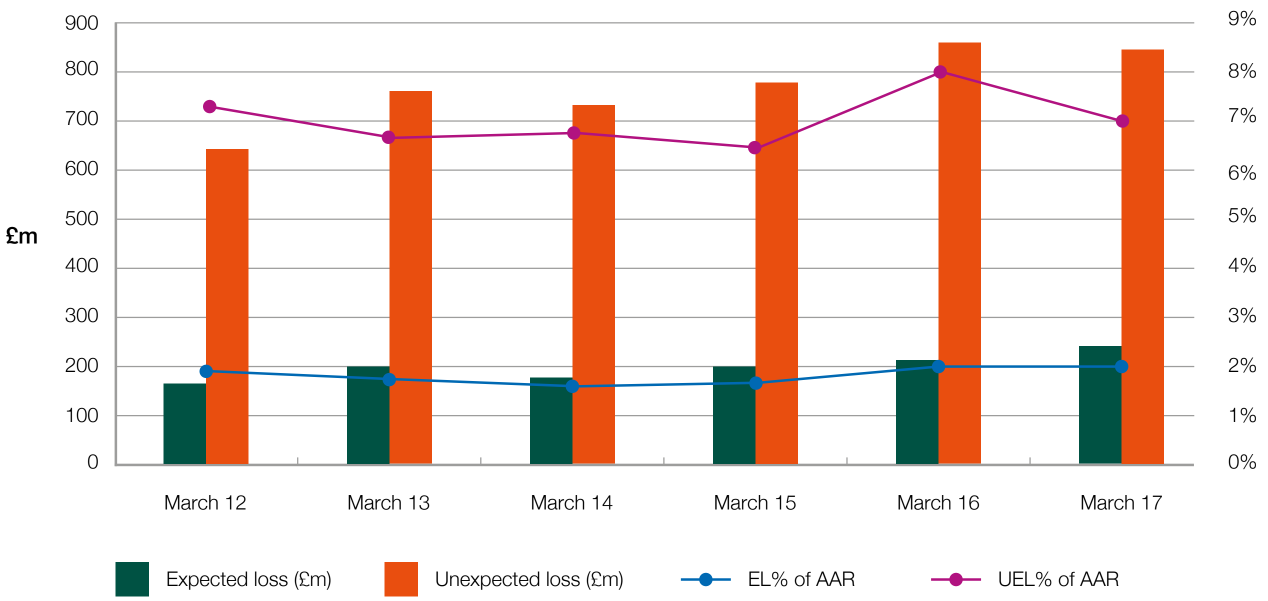
Portfolio expected loss increased from £211 million to £240 million, in line with new business, and therefore at a stable 1.8% of net AAR (the same as in 2016).

Unexpected loss was relatively unchanged at £853 million as of 31 March 2017, from £856 million in 2016, now representing 5.4% of net AAR (7.1% in 2016).

The chart below shows the trend of both these key risk measures over the past 5 years. This shows that expected and unexpected loss rates for the portfolio have remained stable over that period.

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

Expected loss and unexpected loss trend



New claims paid in the year

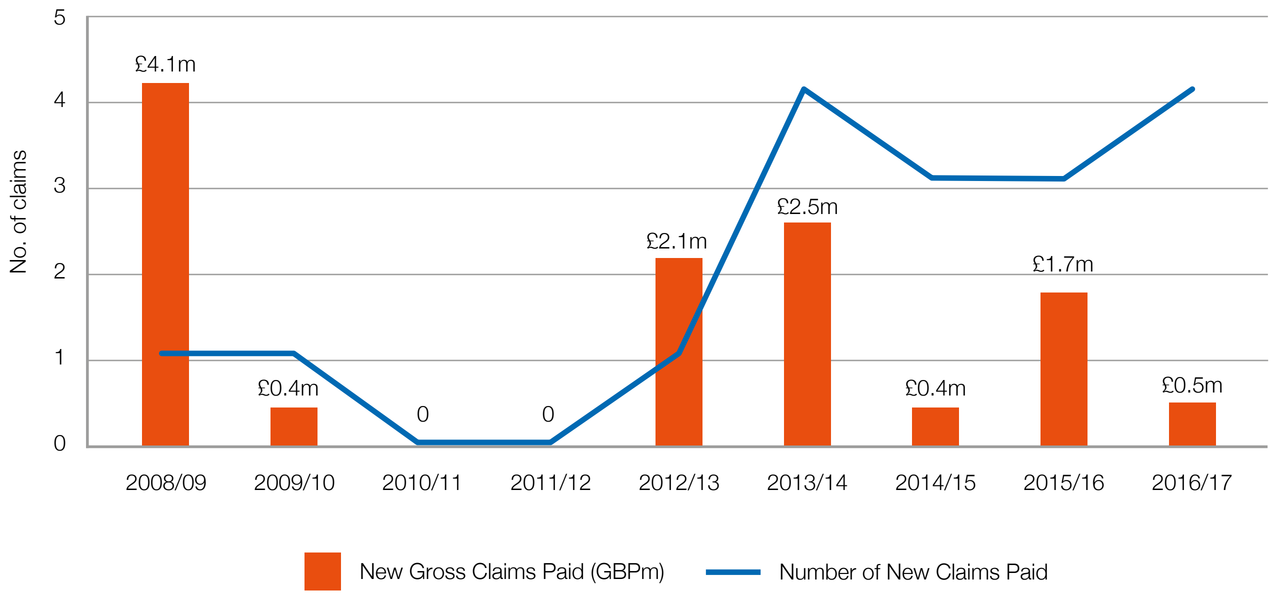
UKEF continued to experience very low levels of claims paid. The low level of new claims is not inconsistent with the average risk quality of the portfolio, informed by rigorous credit risk assessments and good underwriting and structuring of transactions, and high risk management standards more generally.

There have been fewer than expected defaults affecting the short-term EXIP portfolio, given the majority of transactions are in challenging countries, but exposure to this product is relatively modest. Similarly, the predominantly UK SME portfolio, supported under the bond support or working capital schemes, has had a very good record (with only one small loss in the life of the schemes, which were launched in 2011), reflecting the high proportion of bonding facilities which are intrinsically less risky, and the well-established nature of our SME clients.

For claims in 2016–17, we paid a total of £8.8 million (up from £5.4 million in 2015–16).

- Of this, £0.5 million represented claims payments made in respect of new defaults in the year.
- The balance was paid out under guarantees or insurance policies during 2016–17 but was attributable to defaulting counterparties that had occurred in earlier years.
- The new claims pertained to buyers defaulting in Russia and Jordan.

New claims paid in each year since 2008-9



Outstanding claims paid and provisions

The bulk of outstanding claims paid and still to be recovered by UKEF arose on business issued and defaulting prior to 1991. Virtually all the £1.54 billion (up from £1.53 billion in 2016) of outstanding claims paid on this business refers to sovereign exposure that is subject to Paris Club rescheduling, the most significant part of which is for Sudan (including a substantial amount due to accrued interest). The overall provision amount for this business increased slightly on 31 March 2017 to £1.18 billion (up from £1.17 billion in 2016) mainly due to accrued interest, with provision rates stable or reducing.

Outstanding claims paid from business issued after 1991 have reduced slightly in the year, standing at £414 million at 31 March 2017 (down from £458 million in 2016), in line with scheduled repayments overtaking increases in accrued interest. Sovereign exposure in Zimbabwe and Indonesia (the latter rescheduled at the Paris Club and performing in accordance with the agreed rescheduling) makes up the majority of this. Historical aerospace claims are also paying down in accordance with agreed rescheduling.

Recoveries

Overall recoveries (on all business, both principal and interest) amounted to £150 million (£160 million in 2015–16), reducing total recoverable claims (excluding interest on unrecovered claims) to £800 million (£876 million in 2015–16). The majority of recoveries (£120 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. Claims payments for Iranian exposure, previously held up by sanctions, have now all been repaid.

Risk appetite limit

The 99.1% value point of our portfolio loss distribution increased in the year, reflecting the increase in expected loss and provisions, and was standing at £1.36 billion at year-end (£1.33 billion for 2016) and remains comfortably within the limit set by HM Treasury of £5 billion.

Portfolio stress testing

The portfolio of business issued since 1991 is subject to regular stress testing and scenario analysis. The portfolio's sensitivity to changes in ratings and recovery rates is detailed below. None of the movements in the 99.1% shown would cause a breach of our risk appetite limit.

Portfolio stress tests[16]

(£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	226	87	397
Increase in 99.1 percentile point	372	218	867

Other financial objectives

As well as staying within our risk appetite limit, UKEF complied with all other credit-related financial objectives set for us by HM Treasury as detailed on page 36.

Market risk management

Context

Market risk is the risk of losses arising from movements in market prices. For UKEF, this arises from changes in interest rates and 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 two main areas:

- **transaction risk:** for UKEF, this is the risk of changes in the value of foreign currency interest receipts on conversion into sterling
- **translation risk:** this 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

16 This stress test is based on the complete UKEF portfolio. The corresponding sensitivity analysis presented on page 194 in Note 21 of the accounts is based on a portfolio confined to insurance contracts only, as defined by our accounting policies.

Interest rate risk

Fixed rate export finance scheme

Until 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
- before closing 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 addressing 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.

- 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, along with several other reporting provisions relating to the scheme, are approved annually by the Credit Committee. Periodic sensitivity analysis is carried out on the portfolio to gauge the financial impact of interest rate movements on UKEF

Direct lending

In 2014, UKEF introduced a direct lending facility. This 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 that confirms 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 (usually USD). This exposes 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, so no active hedging is undertaken. This is based on a number of HM Treasury considerations:

- our foreign currency assets and liabilities generally have long tenors such that the transaction risks can extend long 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
- 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 two 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. Accordingly, changes in the sterling value of 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 2016–17, thereby reducing UKEF's further 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 194).

Foreign currency risk

As UKEF does not hedge its foreign currency risk, our financial results will inevitably be affected by changes in the value of sterling relative to those currencies in which we transact business. Note 21 of the accounts includes details of the currency profile of our insurance assets, financial instruments and capital loan commitment (see page 195). The Chief Financial Officers report describes the overall impact of foreign exchange movements on our 2016–17 results on page 95.

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 only secure those resources at excessive cost. As a government department, UKEF can draw on the Exchequer to meet its financial obligations as they fall due, if 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. Regarding 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 205).

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, between the last opportunity to adjust voted control totals in January to the year end on 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.

GE workers at its subsea manufacturing facilities in Montrose, Scotland

Chief Financial Officer's report Cameron Fox

This report summarises and highlights the department's financial performance for the year ended 31 March 2017. Given the importance of the management of UKEF's portfolio, this report should also to be read in conjunction with the Chief Risk Officer's report. The detailed financial performance commentary (see below) for the year has been divided into operating segments (lines of business) and there is also a summary of UKEF's overall performance against resources voted by Parliament.

Overall results

UKEF achieved an operating surplus for the year ended 31 March 2017 of £149 million compared with £106 million for the year to 31 March 2016. The increase in net operating income for the year was largely as a result of a higher foreign exchange gain of £57 million for 2016-17 compared with a gain of £13 million in 2015-16.

Foreign exchange: as a significant proportion of UKEF's guarantees, insurance policies and loans are written in foreign currencies (mainly the US dollar), UKEF is thereby exposed to foreign currency risk and associated volatility in terms of the financial results (UKEF is not authorised by HM Treasury to hedge exchange rate exposures – refer Chief Risk Officer's report for further details). During the year, Sterling depreciated by approximately 13% against the US dollar (refer Note 21 of the financial statements which includes details of the currency profile of our insurance assets, financial instruments and capital loan commitments).

Operating expenses: these were broadly similar in 2016-17 at £30 million compared with 2015-16. While there was a planned increase in staff costs, this was offset by lower marketing spend and other administration costs. UKEF also delivered a number of efficiencies related to Spending Review 2015 saving commitments.

Interest and claims credit: over the course of 2016-17 there were a number of reductions in provision rates on a range of markets as well as the recovery of claims and interest on performing markets resulting in provision releases.

Long-term assets and liabilities: given the nature of the business that UKEF supports the department has a significant holding of long term assets and liabilities.

The major asset of UKEF, being net recoverable claims (denominated in a range of currencies), decreased from £429 million in 2015-16 to £368 million during the year. Gross claims reduced from £0.9 billion to £0.8 billion as recoveries were made.

Reserving for Insurance liabilities: UKEF applies the fund basis of accounting (see the financial statements for a fuller explanation) for its medium and long term business. At the end of the year the (net) Underwriting funds stood at £582 million compared with £547 million at the end of 2015-16. Releases from the funds during the year (being business written in 2007 and 2013) was some £18 million in 2017-18. This release (which is a surplus of premium written over risk and costs of writing the business) shows the quality of the underwriting and credit decisions made back in 2007 & 2013. Indeed over the past 5 years UKEF has released a surplus in excess of £135 million over the expected loss on the business written and any costs associated with writing the business.

Accounts 1 to 5

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

- 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).

Management Commentary — 5-year summary

	2016-17 £m	2015-16 £m	2014-15 £m	2013-14 £m	2012-13 £m
Overall Value of Guarantees and Insurance Policies:					
New Business Supported - Net of reinsurance	**2,178**	**1,507**	**2,685**	**2,272**	**4,291**
Amounts at Risk - Gross of reinsurance	**18,859**	**17,111**	**18,672**	**17,195**	**18,141**
Statement of Comprehensive Net Income:					
Premium Income Net of reinsurance	**102**	**73**	**104**	**120**	**133**
Staff, other administration and operating costs	**30**	**30**	**31**	**26**	**20**
Net Operating Income – total	**149**	**106**	**129**	**50**	**135**
– Account 1	63	33	41	18	66
– Account 2	70	64	81	19	59
– Account 4	4	6	7	13	10
– Account 5	12	3	-	-	-
Statement of Cash Flows:					
Claims Recoveries – total	**120**	**133**	**115**	**108**	**98**
– Account 1	47	49	44	38	36
– Account 2	73	84	71	70	62
Interest Recoveries in the year – total	**31**	**28**	**25**	**27**	**38**
– Account 1	28	24	22	23	30
– Account 2	3	4	3	4	8
Claims Paid – total	**8**	**5**	**6**	**13**	**7**
– Account 1	-	-	-	-	-
– Account 2	8	5	6	13	7
Net Cash Flow from Operating Activities – total	**272**	**199**	**237**	**205**	**274**
– Account 1	74	73	65	59	66
– Account 2	158	109	165	138	198
– Account 3	-	-	-	-	-
– Account 4	3	5	6	8	10
– Account 5	37	12	1	-	-
Statement of Financial Position:					
Recoverable Claims before provisioning	**800**	**876**	**996**	**1,075**	**1,228**
– Account 1	515	539	583	609	675
– Account 2	285	337	413	466	553
Recoverable Claims after provisioning	**368**	**429**	**531**	**605**	**711**
– Account 1	223	234	264	284	317
– Account 2	145	195	267	321	394
Interest on Unrecovered Claims after provisioning	**134**	**134**	**143**	**146**	**155**
– Account 1	133	133	142	145	153
– Account 2	1	1	1	1	2
Underwriting Funds - Net of reinsurance	**582**	**547**	**553**	**542**	**478**
– Account 1	-	-	-	-	-
– Account 2	582	547	553	542	478
– Account 3	-	-	-	-	-
Recoverable Capital Loans before provisioning	**381**	**119**	**82**	**104**	**138**
– Account 4	32	51	75	104	138
– Account 5	349	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 £63 million, an increase from operating income of £33 million in 2015-16.
- Recoveries of claims paid were £47 million compared with £49 million in 2015-16.
- Recoveries of interest on claims paid were £28 million compared with £24 million in 2015-16.
- The balances for gross claims decreased from £539 million in 2015-16 to £515 million during the year, while those for net claims decreased from £234 million in 2015-16 to £223 million during the same period.
- Interest on net unrecovered claims has not changed from £133 million in 2015-16. Whilst recoveries were made in year foreign exchange and provision changes meant there was no overall movement.
- There is no non-claims exposure on this account.

Account 2

The key results were as follows:

- The total of guarantees and insurance policies (net of reinsurance) that were issued and effective during the year was £2,178 million compared with £1,507 million at 31 March 2016.
- Net premium income was £102 million compared with £73 million in 2015-16.
- Net operating income was £70 million compared with £64 million in 2015-16. The increase in net operating income was due to a larger foreign exchange gain of £23 million in 2016-17 compared with a gain of £5 million in 2015-16.
- Claims authorised and paid or payable during the year increased to £8 million from £5 million in 2015-16.

- Claim recoveries for the year were £73 million compared with £84 million in 2015-16.
- Gross claims balances were £285 million compared with £337 million in 2015-16.
- Net claims balances were £145 million compared with £195 million in 2015-16.

Account 3

No new guarantees were issued or claims made on this account during the year. 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 £32 million from £51 million in 2015-16, as regular instalments were made.
- Net operating income was £4 million in 2016-17 compared with £6 million in 2015-16.

Account 5

This account relates to direct lending activity. During the year 2 new loans were originated (5 loans were originated in 2015-16).

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.

	SoPS Note	2016-17 Estimate £'000	2016-17 Outturn £'000	2016-17 Variance £'000
Budget spending:				
Departmental Expenditure Limit (DEL)	SoPS1(a)	1	-	1
Annually Managed Expenditure (AME)	SoPS1(a)	120,320	(149,382)	269,702
Resource Total & Net Operating Cost / (Income)		**120,321**	**(149,382)**	**269,703**
Non Budget / Resource Total	SoPS1(a)	-	-	-
Net Resource Outturn & Net Operating Cost / (Income)		**120,321**	**(149,382)**	**269,703**
Budget spending:				
Departmental Expenditure Limit (DEL)	SoPS1(b)	300	64	236
Annually Managed Expenditure (AME)	SoPS1(b)	935,376	250,724	684,652
Capital Total Payments / (Receipts)		**935,676**	**250,788**	**684,888**

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 £270 million – This variance is largely due to provision and foreign exchange movements (in particular in relation to a weakening of sterling against the US dollar of some 13%during the year) which cannot be forecast with certainty and are unhedged. A more detailed explanation of UKEF's foreign exchange risk can be found in the Chief Risk Officer's report in the Performance section and Note 21 of the Financial Statements.

Capital – Note SoPS1(b):

AME £685 million – This variance is largely due to the direct lending facility. Most business is written in currencies other than Sterling therefore it is subject to foreign exchange volatility. The variance is largely due to the fact that whilst it is necessary to ensure there are sufficient voted funds, and therefore headroom to meet potential demand in year, it is not possible to predict actual demand (and therefore the associated drawings). Many deals may not close for reasons beyond the control of the department or the timing of loan origination changes. More details of UKEF's risks, including foreign currency and liquidity risk, can be found in the Chief Risk Officer's report.

Bee'ah's headquarters was designed by the late Dame Zaha Hadid, the world-renowned British architect. It will be built by Carillion and will be the first building of its kind in the city of Sharjah to be powered entirely by renewable and recoverable energy sources, while utilising recycled materials in its construction.

Head of Environmental and Social Risk's report Helen Meekings

UKEF examines environmental, social and human rights (ESHR) risks and potential impacts of projects it is asked to support in line with our published ESHR policy. In addition, we collaborate with other export credit agencies and financial institutions in the field of ESHR matters, with the aim of establishing a 'level playing field' in respect of ESHR risk management across these institutions.

2016–17 was the first year that UKEF applied the Equator Principles – an environmental and social risk management framework adopted by financial institutions – after having adopted the principles on 31 March 2016.

During 2016–17, transactions that fell within the scope of the OECD Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence (the 'OECD Common Approaches')[17] and/or the Equator Principles were screened for ESHR risks. 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, occasionally supported by external technical ESHR consultants. In undertaking ESHR reviews, we place emphasis on early dialogue with exporters and 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 Financial Corporation's (IFC) Performance Standards on Environmental and Social Sustainability.

ESHR due diligence

In 2016–17 we worked with a wide variety of project developers and exporters to help them understand and manage ESHR risks associated with their project activities. We supported one category A and no category B transactions that fell within the scope of the OECD Common Approaches. No transactions within the scope of the Equator Principles had reached financial close this year.

17 The OECD Common Approaches was revised on 7 April 2016. All new cases received by UKEF in the financial year 2016–17 were reviewed in alignment with this revised version.

The following are examples of projects supported in 2016–17 where UKEF made a positive influence on project ESHR risk management:

- Oil and gas exploration and production facilities in Ghana
  This project was considered to be high EHSR risk, category A, with inherent risks associated with the project activities, the potential for diverse and broad ranging impacts together with the presence of sensitive receptors both on – and off-shore. We collaborated with the International Financial Corporation (IFC) and other lenders in undertaking our ESHR due diligence review and were satisfied that, through a suite of proposed ESHR management tools, the project ESHR risks would be appropriately managed. We will continue to work with the IFC and others in monitoring the project during construction and operations phases to maintain the project's alignment with the international standards.
- Construction of a new head office for Bee'ah Sharjah Environmental Company in United Arab Emirates
  We worked collaboratively with the contractor and developer of this iconic headquarters building, including an on-site photovoltaic solar power plant. The case was classified as medium ESHR risk, category B, with impacts expected to be localised and mitigation measures readily available. Sustainability is at the heart of the design of this project, with low carbon emissions and water consumption during operations, and minimal material consumption during construction. Our support is subject to the monitoring of ongoing ESHR risks and impacts to demonstrate ongoing alignment with the international standards.

You can find details on our website of the ESHR risk and impact categorisation of all civil (non-aerospace) cases for which support was issued during 2016–17 that fall within the scope of the OCED Common Approaches and/or Equator Principles.

ESHR monitoring

UKEF monitors category A and 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. Our monitoring includes reviewing self-monitoring reports produced by project developers, commissioning monitoring conducted by an independent environmental and social consultant (IESC) on behalf of UKEF, or UKEF carrying out site visits. The level and frequency of our monitoring varies in line with the ESHR risks involved.

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

- to promote positive health and safety behaviours, 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 for 2016–17:

- Liwa plastics project in Oman
  Our ongoing ESHR monitoring of this high ESHR risk project is utilising an IESC. We are working collaboratively with another ECA to ensure the project remains aligned with the relevant international standards. This has included us seeking additional information on environmental, health and safety related matters.
- Brazilian state oil and gas company (Petrobras)
  We continue to monitor the ESHR management of Petrobras' operations relating to their line of credit. We undertook an annual partnership visit to Petrobras' environmental, health and safety team to monitor how they manage their ESHR risks in line with the relevant international standards and to understand any changes they have made to their ESHR management systems.
- Nghi Son refinery and petrochemical project in Vietnam and Sadara production complex in Saudi Arabia
  Both projects are moving from their construction to pre-commissioning and commission phases. Ongoing monitoring has focused on health and safety issues relating to simultaneous operations (simops). We have worked with our other ECA colleagues to obtain further clarifications on ESHR management relating to simops activities.
- The Blue Waters Island development in the United Arab Emirates
  We have undertaken ongoing monitoring of this medium ESHR risk infrastructure project with a focus on migrant labour-related management issues.

A summary of cases that fall within the scope of the OCED Common Approaches and/or Equator Principles where we are undertaking ongoing ESHR post-issue monitoring can be found on our website.

International ESHR cooperation

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 ECAs at the OECD Environmental and Social Practitioners' Group of the Export Credit Group (ECG). We are actively involved in setting the agenda, sharing experiences, participating in working groups and seeking to achieve consistency in the approach to ESHR risk management practices of ECAs fulfilling the requirements of the OECD Common Approaches.

We were active in facilitating the output of an OECD Guidance Note on Good Practice in the use of Consultants by Export Credit Agencies which was published by the OECD on 8 November 2016.

In our first year as an Equator Principles Financial Institution (EPFI), we were actively involved in the Equator Principles Annual General Meeting held in London, sharing our experiences and engaging and collaborating with EPFI colleagues.

UKEF additionally participates in a number of multilateral financial institution ESHR practitioner meetings. This includes the International Financial Corporation's

(IFC) Community of Learning, as well as meetings of other development banks, commercial banks and ECAs. UKEF also attends a number of international ESHR industry conferences, including the annual conference of the International Association of Impact Assessment, at which this year we presented a paper on the use of environmental and social impact assessments (ESIAs) by OECD ECAs.

Other ESHR matters

We published on UKEF's website an updated Note on Human Rights and Social Risks and Impacts that outlined how we consider such risks and impacts.

We helped companies such as Tekmar, JDR Cables and Bifab with contracts worth more than £200 million to supply offshore wind energy projects.

Export Guarantees Advisory Council annual report Andrew Wiseman

Originally established under the Export and Investment Guarantees Act 1991, the Export Guarantees Advisory Council's role is to advise the Secretary of State on the policies that UKEF applies when doing business, particularly those related to the application by UKEF of ethical policies established by international agreements that relate to export credit agencies.

These are generally policies related to the potential environmental and human rights impacts of the export transactions and projects UKEF supports, debt sustainability and anti-bribery and corruption procedures. The Council also considers transparency issues (including freedom of information).

The Council underwent some administrative changes in 2016-17, when the Department for International Trade was established under the Secretary of State for International Trade. As Secretary of State, Dr Liam Fox took over the responsibility for UKEF which had previously resided with the Secretary of State for Business, Innovation and Skills.

Separately, the Council underwent a change in classification after the Cabinet Office's Review of the Administrative Classification of Public Bodies. As a result the Council had its classification as a non-departmental public body (NDPB) reviewed, and was re-designated as an Expert Committee, a new category for groups comprising of external (non-civil service) specialists that form committees to advise ministers on particular policy areas.

Although the classification of the Council has changed, there has been no material change to its statutory role. The Council does not have executive powers and therefore is not involved in decision-making relating to UKEF support for particular export transactions, but can give advice directly to Ministers, or through UKEF officials, on the application of ethical policies. During 2016-17, the Council met on 4 occasions and separately met with the Minister of State for International Trade.

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

Chair

- Andrew Wiseman (Partner, Harrison Grant Solicitors)

Members

- Gillian Arthur (previously 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 (Corporate anti-bribery adviser; former Director, Ethics and Business Conduct, CH2M HILL Group; former Trustee, Transparency International)
- John Newgas (over 20 years' experience in the manufacturing industry)
- Anna Soulsby (Associate Professor of Organisational Behaviour, Nottingham University Business School)

Senior officials from UKEF including the Chief Executive attend each of the Council's meetings. They briefed the Council on issues and developments over the year, and on individual export transactions supported by UKEF.

Equator principles and loan conditions

Over the course of the year, the Council was consulted on work related to UKEF's adoption of the Equator Principles. The Council was fully supportive of UKEF joining international financial institutions and ECAs in a global framework to promote sustainable environmental, social and human rights decision-making in financing projects.

The Council was also consulted on UKEF's use of environmental and social (E&S) clauses in loan documentation. A review by UKEF on the use of these clauses has resulted in a more consistent approach to how E&S conditions are negotiated, which is aligned with the Equator Principles. In the Council's view, the approach better reflects current sector best practice and strengthens reporting, monitoring and site visit requirements.

Anti-bribery and corruption

In 2016, OECD member countries discussed a review of the OECD Recommendation on Bribery and Officially Supported Export Credits (OECD Bribery Recommendation). The Council provided advice to UKEF in advance of the multilateral negotiations, supporting the UKEF approach to strengthening the recommendation to raise standards in other ECAs to ensure that UK exporters were not put at a disadvantage. The Council also was regularly consulted on UKEF's anti-bribery and corruption procedures, which are covered in more detail in the Governance Statement and Enterprise Risk sections of the Annual Report on pages 121 and 135.

Each year, the Council also reviews the application by UKEF of the OECD Bribery Recommendation, and in February, considered the annual report from UKEF on its application of the Recommendation. The annual report includes the number of applications made, showing those involving the use of agents, the use of arrangements that restricted information on the identities of agents to three UKEF staff (Special Handling Arrangements[18]). The report provides a picture of anti-bribery due diligence carried out by UKEF over the year.

OECD Common Approaches

In 2016-17 a revised text of the Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence (OECD Common Approaches) was adopted by OECD Members. UKEF's application of the Common Approaches is covered in the Head of Environmental and Social Risk's report on page 103.

The Council scrutinises UKEF's application of the OECD Common Approaches, receives regular reports on projects which UKEF has supported and reviews projects which have been classified as Category A or B. The Council's review of category A or B projects take place after UKEF support has been provided, and continue regularly for those projects where UKEF monitors ESHR performance throughout the operation phases of the project.

In 2016-17, the Council reviewed the monitoring work undertaken during a post-issue visit to a project supported by UKEF in Sri Lanka, which involved the construction of over 500 bridges in rural areas. The Council scrutinised the preservation and reinstatement activities associated with the project and noted how regular ECA monitoring of the project had improved ESHR behaviours through training and capacity building.

UKEF also reported to the Council on the ESHR Review of the Liwa Plastic Industries Complex project in Oman. The project involves a natural gas/liquids extraction facility, pipeline and petrochemical plant in central and northeast Oman. Given the nature of the project, which comprises the development of new and large scale assets from both the oil and gas and petrochemical industries, and the potential for diverse risks associated with both environmental and social impacts, the project was classified as a Category A project. The Council heard how UKEF had taken the lead in coordinating the ECA ESHR teams and had visited the site to monitor application of ESHR policies.

In 2016-17 the Council paid particular attention to potential gender issues in connection with projects supported by UKEF and requested a report from UKEF on the international standards relating to gender equality and how UKEF approaches gender equality issues relating to the projects it supports. The Council studied UKEF's initial findings from research into how the issue was considered by other ECAs and IFIs. The Council welcomed UKEF's approach and advised that UKEF could take a leadership role in this area amongst ECAs and project sponsors, by emphasising the positive benefits of gender equality and raising gender issues with project sponsors and exporters at early stages of the projects.

Sustainable lending

Since 2008, OECD members have followed a set of Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low-Income Countries. In 2016 the Council considered the proposals to review the OECD rules and examined how the proposed updates would impact

18 As of April 2017 Special Handling Arrangements have been discontinued.

UKEF decision making. The Council noted that UKEF would continue to require HM Treasury consent and would consult with the Department for International Development and in-country UK government posts, in addition to undertaking its own sustainable lending assessment to ensure that the project would result in a significant and sustainable economic or social benefit for the country without creating an undue strain on the public finances.

Other

Throughout the course of the year, the Council reviewed UKEF's handling of information requests made under the Freedom of Information Act and the Environmental Information Regulations. The Council recognised the very high proportion of requests answered within statutory deadlines.

The costs of operating the Council during 2016-17 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 its meetings and contact details can be found on the government's website – 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 8105 or email CXO@ukexportfinance.gov.uk.

Andrew Wiseman