



UK Government
Investments

ANNUAL REPORT ON THE UK GOVERNMENT'S CONTINGENT LIABILITIES, NOVEMBER 2023

Contents

Foreword from the Director of the CLCC	3
Executive Summary	5
Chapter 1: Contingent Liabilities in Government	11
Summary.....	11
Introduction	11
Risks arising from contingent liabilities.....	12
Aims of this report	13
Scope of this report	13
Application of on-budget and off-budget liabilities	16
Measures of cost.....	18
Data sources and limitations	18
Chapter 2: On-budget Liabilities	20
Summary.....	20
Introduction	21
Portfolio summary	21
Government responsibilities	22
Government as guarantor	27
Government as insurer.....	28
Data sources and limitations	31
Chapter 3: Material Financial Guarantees	34
Summary.....	34
Introduction	35
Note on data sources and measure of cost.....	36
Portfolio summary	36
Government’s remuneration for the risk undertaken	38
Performance of material guarantees and guarantee schemes	38
Chapter 4: Off-budget Liabilities	53

Summary.....	53
Introduction	54
Note on data sources and measures of cost.....	54
Portfolio summary	55
Concentration of risk.....	57
Past crystallisations.....	58
Charging premiums	58
Economic sectors and triggers	59
Comparison with accounting information	64
Data notes and limitations	64
Chapter 5: Improving the Management of On-budget and Off-budget Liabilities	66
Annex A: Definitions	69
Annex B: Contingent Liability Categories	72
Annex C: Scope.....	74
Annex D: Data Sources and Limitations	76
Annex E: Checks Performed.....	82

Foreword from the Director of the CLCC

The risks that fall to government can be unique and often complex. The Contingent Liability Central Capability (CLCC) was established within UK Government Investments (UKGI), in partnership with the Government Actuary's Department (GAD), in 2021. This team was set up to examine, report and advise on government's contingent liabilities. In the two years since its inception, the CLCC has undertaken a significant programme of work to meet these objectives.



To date, the CLCC has supported government departments to structure and reliably estimate the risk on over 100 new contingent liabilities. Of these, around 20% represented a quantified maximum exposure of over £1bn. Simultaneously, the CLCC has produced a range of best practice guides on topics including charging, contingent liabilities in procurement and estimating losses. Totalling more than 1,800 downloads, these guides respond to issues raised by finance teams across government. Our aim is to improve efficiency by standardising many aspects of contingent liability management and reporting across government.

Last year, the CLCC published its inaugural report which laid the foundation for how the team would identify and analyse government's stock of contingent liabilities. A key part of the CLCC's remit is to commission departments for analysis of risk, support them in quantifying this risk and to harmonise information from across government. This information is often reported in multiple formats and has some uncertainty that impacts future spend by government. Through active collaboration with 17 central government departments, the CLCC has extracted and analysed thousands of data points relating to over 900 financial products, tools and commitments to build a portfolio view of government's potential exposure to future contingent liability costs.

Overall, government has a good understanding of its exposure at a departmental level. The introduction of the HM Treasury *Contingent Liability Approval Framework*¹ in 2017 systemises best practice and ensures parliament is informed of new contingent liabilities, a core objective of *Managing Public Money*². The work of the CLCC supplements financial reporting, providing information that informs government fiscal planning. For the first time, this report constructs data that enables government to view the portfolio of exposure, as opposed to a bottom-up department led process, and thereby consider the impact from

1 www.gov.uk/government/publications/contingent-liability-approval-framework

2 www.gov.uk/government/publications/managing-public-money

a potential cost perspective. The data is crucial to allow government to understand and manage exposure, information which has never before been available.

As a result of the work the CLCC has undertaken, we can now provide enhanced transparency across a range of liabilities. We found that central government departments reported £491bn of risk arising from contingent liabilities and provisions in line with accounting standards. We also know from the data that has been compiled by the CLCC that government is responsible for a further 933 contingent liabilities and that this represents £23bn of risk which, while not new, has not previously been quantifiable. The data collated by CLCC forms the first step in building an invaluable proprietary data hub for government which will inform future policies and improve decisions.

This work demonstrates government's commitment to fiscal discipline, transparency and efficiency. We will work with HM Treasury and departments to integrate the management of contingent liabilities and the risks they pose into wider fiscal management.

Siobhán Duffy

Director, Contingent Liability Central Capability

Executive Summary

Introduction

The UK government defines contingent liabilities as fiscal commitments undertaken by the government that are uncertain in terms of timing and quantum and lead to future spending if certain discrete event(s) occur.





Governments often take on risks that others cannot to achieve specific policy outcomes designed to benefit the taxpayer. This can include instances where governments act to protect the public and provide stability. Such risks can arise from a variety of financial products, tools and commitments including guarantees, indemnities, legal cases, and purchaser protections. These are often grouped within accounts as contingent liabilities, provisions, insurance indemnities or financial guarantees.

It is essential for governments to effectively manage these risks as they can otherwise lead to deviations from expected fiscal outcomes through unplanned expenditure, which may result in higher borrowing, debt, taxation or offsetting reductions in spending.

Scope of this report

Government needs the right data and analysis to holistically manage its contingent liability portfolio and associated fiscal risk. Without the insights generated from this, government has not been able to model the impact of new proposals on its aggregate exposure. As highlighted in our 2022 report, this is due to the limitations of relying solely on accounting information. Supplementing accounting information with management information better informs risk management³.

By addressing these limitations for the first time, this report aims to:

-  1 Identify the scale of contingent liability risk held by government.
-  2 Categorise the risk by identifying beneficiaries and concentrations to better understand the overall composition of the portfolio.
-  3 Determine whether government charges adequately for the risk it takes on.
-  4 Consider how to improve value for money across the portfolio.

³ www.ukgi.org.uk/2022/06/23/the-contingent-liability-central-capability-exploring-the-uk-governments-contingent-liabilities/

This report focuses on factors that influence the risk arising from contingent liabilities and other areas of the balance sheet that share an element of uncertainty. Our analysis is directed at a range of financial products, tools and commitments that can be grouped as ‘on-budget’ or ‘off-budget’ liabilities based on whether they are captured on the balance-sheet (e.g. provisions) or disclosed under government financial reporting standards (e.g. contingent liabilities).

Breaking this down, we distinguish between exposure that arises from schemes expressly designed to support the private sector through government acting as guarantor or insurer and schemes that may support the private or public sectors where they relate to an obligation that the wider public sees as government’s responsibility. This latter group can include schemes such as NHS clinical negligence claims whereby government compensates private individuals who raise a successful claim to support the delivery of NHS care. In this report, we will refer to these three distinct groups of exposure as ‘*government as guarantor*’, ‘*government as insurer*’ or ‘*government responsibilities*’. Further details are provided in **chapter 1**. In continuation of Report 2022, we have focused on central government’s contingent liability portfolio across the accounts of 17 departments which encapsulates the majority of government exposure.

Unit of measurement

The analysis underpinning this report is focused on estimated accrued future cost (or expected cost). This is an estimate that refers to the expected (i.e. probability-weighted) outstanding lifetime gross future cost to government arising from past decisions or activities.

Measuring the value of contingent liabilities and other uncertain items across government’s portfolio in this way provides a more realistic estimate of government’s aggregate risk than utilising metrics such as maximum exposure. Using the latter at a portfolio level can result in an inflated measure of risk as it assumes a worst-case scenario across every liability, even where there is some diversification of risk.

The expected cost does not take into account any income received through fees or premiums charged by government (e.g. when taking on risk from the private sector) or any assets (or contingent assets) held against the liabilities. In this report, we have analysed the extent to which charging is used to reimburse government for the risk it takes. In many cases, particularly where it is acting as guarantor, the government more than covers its expected cost by charging for the risk it takes on for the private sector. However, we do not present figures net of income from charging or other income. This is because income received from schemes will often have been used to pay for current expenditure, or reduce government borrowing, and will not be clearly evident on the asset side of department’s balance sheets. However, we will consider this further for future reports.

On-budget liabilities

‘Government as guarantor’ and ‘government as insurer’

More than 90% of government risk (£491bn) is accounted for on its balance-sheet. Analysing the expected cost of on-budget liabilities we find that £8bn arises from government acting as insurer and £18bn from government acting as guarantor. While government controls the decision to issue guarantees or indemnities to support the private sector, once committed, it potentially has less control over the risks that may arise from them.

The most significant exposure is to COVID-19 loan guarantees, with an expected cost of £15.8bn. As a sub-set, the Bounce Back Loan Scheme (BBLs), is the largest component in the cluster of interventions used to protect the economy during the pandemic, with an expected cost of £14bn. As of 30 June 2023, £6.9bn in claims has been paid out under the BBLs. While this remains subject to robust monitoring, reporting and management arrangements, an increase in company insolvencies could result in further losses.

In contrast, all other on-budget guarantees and guarantee schemes government has entered we characterise as business-as-usual. These will typically have a longer planning horizon, allowing time for thorough structuring to optimise risk-sharing. This is evidenced by the lower expected costs for these schemes. Government has however needed to deliver both guarantee and insurance schemes at pace, such as during the COVID-19 pandemic (with

insurance schemes to support the arts and entertainment industry, or guarantee schemes to support businesses), or in response to energy price shocks (with the Energy Market Financing scheme⁴). It is possible that government will need to consider the rapid rollout of large guarantee or insurance schemes in the future. Drawing on lessons learnt from previous schemes, we will therefore undertake further work to explore how government could best design and implement such schemes at pace. The outputs of this will be designed to support decision making, particularly if a crisis response were to be required in the future.

Figure A.1 – Estimated accrued future cost of on-budget liabilities at end March 2022

Type	On-budget	
	£bn	%
Government responsibilities	465	94%
Government as insurer	8	2%
Government as guarantor	18	4%
Total	491	100%

Government responsibilities

Government has a greater degree of influence where it enters liabilities that arise from situations we refer to in this report as ‘government responsibilities’. Most of government’s on-budget risk arises from this category. It includes items recognised as provisions under accounting rules, such as decommissioning activities linked to nuclear (£263bn) and oil & gas (£11bn) as well as the cost of clinical negligence claims (£128bn). The balancing £63bn is made

⁴ The Energy Market Financing Scheme was designed to support eligible energy firms meet extraordinary margin calls caused by market volatility. There were no applications during the availability period and the scheme closed without any utilisation.

up of 55 additional smaller ‘government responsibility’ items. When performing the analysis for this report, we used the most recent published data from government departments, for financial year ending 31 March 2022. Subsequently, departments have begun to publish 31 March 2023 annual report and accounts.

Many of the larger items described represent spending commitments spanning years into the future (in some cases, beyond 100 years). In accordance with accounting rules, these items are adjusted to reflect the time value of money, where expected future payments are discounted to provide a present value. The discount rates change each year which can significantly affect the accounting value. The quantum of the two largest on-budget commitments (nuclear decommissioning and clinical negligence which represent 80% of the on-budget commitments) will decrease substantially, by around £186bn, when updated to reflect the financial year ending 31 March 2023. This reduction is predominantly due to significant changes to the discount rates. Further details are provided in **chapter 2**.

This highlights the material impact assumptions applied to government responsibilities can have on expected cost. We will work with departments to ensure assumptions applied to government responsibilities are subject to robust testing, scrutiny and actively managed to maximise benefits for taxpayers. We will also work with departments to ensure that where different organisations are disclosing similar types of risks they are estimating this in a consistent manner so costs can be compared.

Off-budget liabilities

Working with government departments this report provides analysis on 933 ‘off-budget’ liabilities for which limited information would be available under accounting standards. This includes financial products, tools and commitments such as guarantees, indemnities, legal cases and purchaser protections that are classed as contingent liabilities. These are disclosed with limited financial information in the notes to accounts in accordance with accounting standards.

This report, for the first time, provides an aggregated expected cost figure for these items (where 50% are classed as unquantifiable under accounting standards). This enables government to understand its overall portfolio of contingent liabilities and the potential for unbudgeted crystallisations.

Using unaudited management information, we have determined the expected cost for off-budget liabilities to be £23bn. 86% of the £23bn expected cost is derived from just 3% of the line items. Of the total, £2bn arises from government as guarantor, with a further £6bn relating to government as insurer. Most of the expected cost arising from off-budget liabilities is derived from government responsibilities which amount to £15bn. The analysis shows that the value of expected cost is heavily influenced by a small number of large items, spanning very long time horizons, within the portfolio.

We have determined that sound monitoring, reporting and management of off-budget items is required as these can still result in material expenditure, although the likelihood of any one item crystallising is remote.

We will work with government departments to embed best practice and combine

data relating to on-budget and off-budget liabilities such that government can consider the impact new proposals may have on its overall portfolio.

We have also examined the economic sectors that the off-budget items relate to, and the triggers that could cause crystallisation events. This enables us to better understand any concentration risk that sits within the off-budget portfolio. Based on the data provided, it appears that the government's portfolio of off-budget liabilities is diversified. There is no one specific sector of the economy to which the government is over-exposed.

Where it was possible to identify a single, specific event that would result in crystallisation, the most significant triggers were identified as successful legal claims (reflecting the large number of legal cases in the portfolio), a major economic or financial downturn, and widespread damage to property.

We will track these elements and conduct further analysis over time to map interdependencies that exist across the portfolio and how this influences its risk profile.

Figure A.2 – Estimated accrued future cost of off-budget liabilities at end March 2023

Type	Off-budget	
	£bn	%
Government responsibilities	15	65%
Government as insurer	6	26%
Government as guarantor	2	9%
Total	23	100%

Conclusions and next steps

In aggregate, across on-budget and off-budget liabilities, we have identified £20bn of expected cost arising from government as guarantor, £14bn from government as insurer and £480bn from government responsibilities. Therefore, government's total expected cost from on-budget and off-budget liabilities is £514bn, and of this £491bn is already captured on government's balance-sheet.

Figure A.3 – Estimated accrued future cost of contingent liabilities and other uncertain liabilities at end March 2022 (on-budget) or at end March 2023 (off-budget)

Type	On-budget	Off-budget	Total	
	£bn	£bn	£bn	%
Government responsibilities	465	15	480	93%
Government as insurer	8	6	14	3%
Government as guarantor	18	2	20	4%
Total	491	23	514	100%

With this information being available for the first time, government will now be able to consider new proposals on their individual merits while also accounting for the impact these will have on its aggregate risk exposure. This will support central management of government's aggregate risk.

Our analysis also highlights that most of government's expected cost arises from a small sub-set of large on-budget and off-budget liabilities. We will focus additional analysis and reviews around these liabilities to test how they are estimated, managed and reported. In addition, we will work with departments to identify correlations and interdependencies that exist across this specific group.

More broadly we will continue to improve the quality of data by working with departments to improve standardisation. This will be focused on reporting requirements on items across the portfolio as well as assumptions and analysis used by organisations to estimate similar types of risk. We will carry out these activities as we continue to aggregate information from departments on an annual basis. Through this we will also track movements across the portfolio and use this as an early warning indicator where the composition of government's portfolio changes significantly.

Working with departments, we will also identify opportunities for contingent liabilities to be tailored in a way that optimises the way in which government support is provided to the private sector. In addition, we have highlighted that most of government's private sector risk arises from material financial guarantees that were developed in a time of crisis. In response to this, we will undertake further work to explore best practice on how to design and implement large guarantee programmes at pace.

We will also use the data that we have, and continue to gather, to develop analysis that can be used by departments to benchmark key metrics on new proposals. This will support the efficiency with which new proposals are developed and considered. In parallel, we will scope where new models can be built as tools to expedite and improve government's estimating capabilities. Over time, we will scope how the analysis we produce can be consolidated into a single platform that will take the form of a Central Liability Monitoring Hub.

Chapter 1: Contingent Liabilities in Government

Summary

- Contingent liabilities, and other uncertain items across government's balance-sheet, can be sources of fiscal risk. These can be on-budget liabilities or off-budget liabilities.
- This report has four aims as it seeks to identify and manage these risks across the government's portfolio: (i) identify the scale of contingent liability risk held by government; (ii) categorise the risk by identifying beneficiaries and concentrations to better understand the overall composition of the portfolio; (iii) determine whether government charges adequately for the risk it takes on; and (iv) consider how to improve value for money across the portfolio.
- Contingent liabilities and other uncertain areas of the balance-sheet can arise through a variety of different financial products, tools and commitments used by government. Each one of these gives rise to different implications from a management perspective.
- We have categorised liabilities based on the nature of the underlying activity that is being supported and the type of intervention used. We also examine whether these items are on-budget or off-budget to consider how they can be best managed.
- The categories we use include government responsibilities, government as guarantor and government as insurer.

Introduction

The UK government has been at the international forefront of government financial reporting and improving contingent liability management. In 2017 it established the *Contingent Liability Approval Framework*⁵ to systemise the management of contingent liabilities. In 2020 it went further and committed to improving

oversight across its stock of contingent liabilities through the *Balance Sheet Review*⁶ and *Insurer of last resort*⁷ reports. This resulted in the CLCC being established in 2021. The intent of this was to integrate the management of contingent liabilities and the risks they pose into wider fiscal management.

5 www.gov.uk/government/publications/contingent-liability-approval-framework

6 www.gov.uk/government/publications/the-balance-sheet-review-report-improving-public-sector-balance-sheet-management

7 www.gov.uk/government/publications/government-as-insurer-of-last-resort--2

Government defines contingent liabilities as fiscal commitments undertaken by itself that are uncertain in terms of timing and quantum and lead to future spending if certain discrete event(s) occur. Contingent liabilities are a versatile tool that can be used to deliver policy objectives. They can take the form of multiple different financial products, tools and commitments that include insurance indemnities, financial guarantees, purchaser protections and legal cases, amongst others. They can also share interdependencies and correlations with similar financial products that arise across other areas of the balance-sheet and share an element of uncertainty.

As highlighted by the Office for Budget Responsibility (OBR) in its Fiscal Risk and Sustainability reports⁸, left unmanaged, contingent liabilities and other areas of uncertainty can become sources of fiscal risk. Fiscal risks are factors that can cause the fiscal outlook to deviate from what was forecast in the medium-term or pose a threat to sustainability over the long term. They can be difficult to anticipate and impact government finances. To help address this challenge, this report considers the government's portfolio of contingent liabilities and other areas of spending uncertainty that interplay with them. In addition, this report considers the impact that these could have on public finances in the future.

In this chapter we first outline the risks that contingent liabilities can pose and explain why they need to be effectively managed. We then introduce the aims for this report and explain the key principles upon which the following chapters will be based. These are the terminologies and typologies used

to describe contingent liabilities and other uncertain areas of the balance-sheet, the measure of cost, and the data underpinning the analysis.

Risks arising from contingent liabilities

Contingent liabilities that are not designed or managed effectively can be a source of excess fiscal risk as they can negatively impact government finances. If not controlled, expenditure from a contingent liability could lead to large increases in public debt, or require spending reductions or tax increases to mitigate the impact.

Similarly, other uncertain items on the balance-sheet, such as provisions arising from government responsibilities, are large in scale. It is essential that sufficient focus is placed on in-year expenditure arising from such items and that this is properly anticipated. Deviations in expenditure in-year and over the lifetime of the liability compared to expected forecasts also pose a fiscal risk to government. Consideration must be given to how these risks are actively managed to maximise benefits for the taxpayer.

Contingent liabilities, in particular, can lead to adverse behaviours. The perception that certain contingent liabilities are 'free' at the point of creation, as they do not immediately increase key fiscal metrics (such as public sector net borrowing), means that contingent liabilities are at risk of being subject to limited scrutiny. This can result in situations where liabilities are not appropriately managed over time and result in higher long-term costs.

Furthermore, private sector beneficiaries of contingent liabilities could also lose their

8 www.obr.uk/frs/fiscal-sustainability-report-july-2018

incentives to adequately manage risk as they are guarded from its consequences. For these reasons, it is essential for government to structure contingent liabilities effectively; in a manner that avoids creating moral hazards and includes appropriate risk-sharing arrangements. Simultaneously, government must be careful not to crowd out private sector activity while also identifying opportunities for charging, where appropriate.

Aims of this report

To help government better manage its portfolio, this report has four aims. These will be reported against throughout this report and summarised in **chapter 5**, including a summary of additional work that we will undertake in the future to further enhance transparency and safeguard fiscal discipline.

Scope of this report



Identify the scale of contingent liability risk held by government – for the first time, bringing together data on ‘on-budget’ and ‘off-budget’ contingent liabilities to better understand the aggregate value of government’s risk.



Categorise the risk – clearly outlining the types of risk held, the beneficiaries and counterparties to better understand the overall composition of government’s contingent liabilities and where these interplay with other risks.



Determine whether government is charging adequately for the risk it takes on – examine whether the government is appropriately compensated for the level of risk it holds.



Consider how to improve value for money across the portfolio – exploring areas across the portfolio that warrant further analysis and opportunities to improve portfolio monitoring, reporting, and structuring of liabilities.

In this report we examine a range of financial products, tools and commitments that are used by government. These include indemnities, guarantees, commitments, legal cases and purchaser protections, amongst others. These are usually grouped within financial accounts as contingent liabilities, provisions, insurance indemnities and financial guarantees. Each one of these items are characterised by an element of uncertainty. This uncertainty can be linked to time, quantum or impact.

Reflecting international and government’s accounting standards, contingent liabilities are typically reported within the notes to accounts with limited financial information and are not recorded on the balance-sheet. For government, this means they are ‘off-budget’ liabilities. This is due to the lack of certainty around their value and likelihood of materialising.

When a liability becomes probable, and its value can be reliably estimated, it is a provision. A provision is recorded on an organisation’s balance-sheet and

represents an anticipated future expense. For government, this means they are ‘on-budget’ liabilities.

Financial products such as guarantees and indemnities represent contractual commitments where one party agrees to cover specified losses incurred by another party due to defined events. These items are both *contingent* in nature and can be

captured as ‘on-budget’ or ‘off-budget’ depending on the likelihood of future obligations arising and level of certainty around potential losses.

Looking broadly at on-budget and off-budget liabilities, as we have done in this report, helps us understand the overall risk held by government, its interdependencies and potential impact on public finances.

Figure 1.A – Classification of liabilities as on-budget and off-budget

	On-budget liabilities	Off-budget liabilities
Description	Items that are, in accordance with accounting standards, included in financial accounts.	Items that are, in accordance with accounting standards, disclosed in the notes to accounts with limited financial information.
Accounting treatment How is information on this contingent liability reported?	Balance sheet liability In accordance with accounting standards, departmental accounts will include a ‘best estimate’ for these items, while recognising there is uncertainty in actual future outturn.	Described in the ‘notes to accounts’ In accordance with accounting standards, these are not recorded in departmental balance sheets because they are considered to be, in isolation, relatively unlikely to crystallise or due to difficulties in estimation. Items are disclosed in notes to the accounts with limited or no quantification.
Accounting terminology	Provisions, financial guarantees, or insurance liabilities.	Contingent liabilities and remote contingent liabilities.
Importance of monitoring Why is it important that we collate and monitor information on these contingent liabilities?	To build a portfolio view There is a risk that on-budget items are mostly managed on a department-by-department basis, and separately from off-budget items. This report brings together a portfolio view to improve oversight and inform policy decisions.	Limited information is available on the quantum and features of this risk Across the government’s portfolio, crystallisations are possible and will need to be met from departmental budgets. Until now, limited financial information has been captured on these liabilities.

In our 2022 report, we examined the published annual report and accounts of government departments to identify central government's portfolio of off-budget liabilities. In line with our findings from 2022, this report is focused on central government's portfolio which is concentrated across the accounts of 17 departments. As a result, this report does not consider contingent liabilities or other uncertain items held across devolved administrations or local government. Furthermore, items such as the Pension Protection Fund (PPF), which are not consolidated through any department's accounts, are also excluded from this report.

An additional insight drawn from our 2022 report was that a significant number of contingent liabilities across government's portfolio are reported to be 'remote' or 'unquantifiable'. These are off-budget liabilities that are deemed to be unlikely to occur or cannot be reliably estimated in line with accounting standards. While government financial reporting rules place an additional obligation, beyond international accounting standards, for departments to disclose these items, often limited financial information is provided beyond noting that the liabilities exist.

To address this, we have sourced and aggregated more detailed information regarding off-budget liabilities, beyond what is required under accounting standards. To achieve this, we have used management information that does not meet the quality thresholds required under accounting standards. Regardless, this information does help to derive a sense of scale of the risk held by government. Combined with data already disclosed across departments' annual report and accounts, this information produces a portfolio picture of government's liabilities.

To better understand the potential impact of on-budget and off-budget liabilities, the analysis within this report considers the role of government. This includes the nature of the commitment made which gives rise to uncertain future costs.

In building a portfolio view, we seek to categorise groups of contingent liabilities, and other uncertain items across the balance-sheet with similar characteristics, to enable relevant portfolio analysis. This allows us to identify certain features and next steps for sub-sets of the portfolio. The categories we have used are set out in **figure 1.B** below. We considered, and dismissed, categorising based on whether the beneficiary of a commitment is a public sector entity or a private sector entity as this can be misleading. For example, private individuals are the ultimate beneficiaries of clinical negligence claims and government has made the commitment to be liable for these claims as part of its provision of healthcare. This report categorised groups of contingent liabilities based on the nature of the activity. Government responsibilities are those that support the delivery of outcomes that the general public view as government's responsibility due to their relation to past public sector related activities. Yet this can benefit public bodies, private sector organisations or individuals.

These differ from commitments that are made explicitly with the intent of supporting the private sector or unlocking capital. This is where government expressly acts as 'insurer or guarantor' for private sector organisations; using some form of insurance, indemnities or guarantees. These factors help us consider the 'typology' of on-budget and off-budget liabilities.

Figure 1.B – Typology of on-budget and off-budget liabilities

Typology				
Government's role What is the nature of the commitment made?	Government responsibilities – future contingent or uncertain expenditure that the government is legally or contractually committed to incurring because of its past public sector related activities. Government as insurer/guarantor – where, in order to achieve its objectives, government provides insurance, indemnities, or financial guarantees explicitly to support the private sector.			
Type What is the type of financial product or tool used to make the commitment?	Guarantees	Indemnities	Legal cases	Purchaser protections
	When the government agrees to pay the debts of a third party if they default.	When the government agrees to cover costs if a certain event occurs.	When a lawsuit is likely to be brought against the government while undertaking its core activities.	Where the government agrees to provide warranties or indemnities relating to asset sales.

Application of on-budget and off-budget liabilities

As set out in the *Government as Insurer of Last Resort*⁹ report, the government has a responsibility to protect the population and provide stability. This can create an obligation, where there is a strong public policy case, to take on risk that the private sector is unable or unwilling to bear and cover the costs if that risk materialises. In such cases, on-budget and off-budget liabilities can often be the most appropriate and cost-effective solution, or the only solution, to meet an obligation. For example, major destabilising events such as the global financial crisis and the COVID-19 pandemic were characterised by wide-scale use of government guarantees and indemnities to help maintain financial and economic stability.

When managed effectively, these liabilities can be tailored to achieve a range of policy outcomes while allowing government to share appropriate levels of risk with the private sector.

The table below provides examples of how such liabilities have been used by government to achieve a range of policy outcomes.

9 www.gov.uk/government/publications/government-as-insurer-of-last-resort--2

Figure 1.C – Examples of on-budget and off-budget liabilities

Objective	Example
<p>Provide indemnities where commercial insurance is unavailable or prohibitively expensive to support public policy or enable procurement</p>	<p>Pool Re indemnity (off-budget)</p> <p>Terrorism events have the potential to cause substantial losses and it is difficult to predict the size, timing, and location of attacks. It is therefore difficult for insurance companies to reliably model the risk.</p> <p>Many insurers had withdrawn from the terrorism insurance market following attacks in the early 1990s and government intervention was deemed necessary given the potentially damaging impact on the wider economy should commercial properties become uninsurable.</p> <p>In 1993 the government introduced Pool Re to cover terrorism insurance on commercial properties. Pool Re covers insurance on nearly £2 trillion of assets in the UK for physical damage relating to conventional terrorist, nuclear, biological, radiological, and chemical attacks. This also includes cyber-attacks which cause physical damage. Insurers pay premiums to Pool Re, which are invested to create pooled reserves that can be drawn on by members if a terrorist event occurs. Should a deficit in the reserve arise government is liable to pay in sums to offset this.</p>
<p>Support and enable innovative policies, improve efficiency, and address market failure by using government backed guarantees</p>	<p>Foreign, Commonwealth and Development Office (FCDO): Ukraine Loan (on-budget)</p> <p>The Russian invasion of Ukraine placed huge pressure on Ukraine's economy and a large, unmet fiscal deficit emerged across 2022/23. Ukraine was unable to source affordable finance from domestic or international capital markets and revenue sources were drying up. Ukraine urgently needed economic, particularly fiscal, support to pay salaries, pensions, maintain safety nets and keep key state functions and essential services operating.</p> <p>As at March 2023, the UK government has provided guarantees totalling \$2bn (with a further \$3bn support announced in June 2023) that allowed the World Bank to rapidly increase the scale of its existing support package to Ukraine. FCDO continues to guarantee both principal and interest repayments from Ukraine to the World Bank.</p>

Measures of cost

To measure the risk held by government this report focuses on estimated accrued future cost (or expected cost) to value the actual risk that government holds across its portfolio.

Definition: Estimated accrued future cost

Estimated accrued future cost provides an estimate that represents an expected (i.e. probability-weighted) outstanding lifetime future cost to government arising from past decisions or activities. This is an appropriate measure of risk because contingent liabilities, by their nature, represent government obligations to potentially incur future expenditure because of past commitments or activities. It also provides a better value of actual risk at the portfolio level. Furthermore, larger items are adjusted to reflect the time value of money, in that future payments are discounted back to the present time.

This is a more appropriate measure than maximum or reasonable worst-case exposure when analysing a diversified portfolio of risk. Using maximum or reasonable worst-case exposure relative to expected cost at the level of an individual liability can be helpful. Using maximum or reasonable worst-case exposure across the portfolio of on-budget and off-budget liabilities can result in an inflated overall figure. Doing so assumes a worst-case outcome across an entire portfolio, the likelihood of which is extremely

remote, particularly where there is some diversification of risk across the portfolio.

The expected cost does not take into account any income received through fees or premiums charged by government (e.g. when taking on risk from the private sector) or any assets (or contingent assets) held against the liabilities. In this report, we have analysed the extent to which charging is used to reimburse government for the risk it takes. In many cases, particularly where it is acting as guarantor, the government more than covers its expected cost by charging for the risk it takes on for the private sector (see **chapter 3** for further examples). We do not present figures net of income from charging or other income. In many cases, income received from schemes will have been used to pay for current expenditure, or reduce government borrowing, and will not be clearly evident on the asset side of department's balance sheets. We will consider this further for future reports.

Data sources and limitations

This report covers on-budget and off-budget liabilities across 17 central government departments. Data relating to on-budget liabilities has largely been captured from departmental annual report and accounts, up to and including the financial year ending 31 March 2022. These are subject to robust accounting and audit requirements in line with *International Financial Reporting Standards (IFRS)* and government's *Financial Reporting Manual (FReM)*.

At the time of writing this report, some departments have begun to publish their annual report and accounts up to the financial year ending 31 March 2023. Certain programmes and policies may have

also released more up to date financial data. For consistency across departments, and to report on total risk across government, we have based this report on data up to 31 March 2022. We have noted any known or expected material changes in results as at March 2023. In addition, we have noted any material changes in policy or programme financial data where this has been reported post-March 2023.

Data on off-budget liabilities was acquired by working across departments to develop and aggregate new management information as at year ending 31 March 2023, where in many instances, this data did not previously exist. This reporting date of 31 March 2023 differs from the date to which on-budget data refers. This is due to off-budget data being aggregated in parallel with the preparation of 2022/23 annual report and accounts.

For further information on sources and limitations of data used in this report, see Annex D.

Chapter 2: On-budget Liabilities

Summary

- This chapter analyses government's portfolio of on-budget items using data from departmental annual report and accounts.
- The total expected cost for on-budget liabilities is £491 billion at March 2022. Of this, £465bn arises from government responsibilities, with £18bn arising where government acts as guarantor and £8bn where government acts as insurer.
- Most of the expected cost is concentrated in a small number of items. Over 80% of on-budget liabilities relate to decommissioning activities (especially nuclear) and clinical negligence claim costs.
- These commitments can be very long-term and this drives the scale of the amounts shown. Their values can vary significantly year-on-year as estimates are dependent on assumptions, including the allowance made for the time value for money (the discount rate), but this does not affect expected annual future expenditure.
- There is limited scope to charge for government responsibilities because they are, by their nature, a consequence of public sector activity. Therefore, our analysis on the scope for charging for risk is focused on government's role as insurer or guarantor (the latter is explored in **chapter 3**).
- The CLCC will conduct further work with departments to test consistency and standardisation linked to the management and quantification of government responsibilities.
- Over 80% of the £18bn expected cost arising from government as guarantor is through financial guarantees arising from COVID-19 support schemes.

Figure 2.A – Estimated accrued future cost of on-budget liabilities as at March 2022

Type	On-budget		Off-budget	Total	
	£bn	%	£bn	£bn	%
Government responsibilities	465	94%	15	480	93%
Government as insurer	8	2%	6	14	3%
Government as guarantor	18	4%	2	20	4%
Total	491	100%	23	514	100%

Introduction

This chapter analyses on-budget liabilities; those recognised in financial statements within departmental annual report and accounts in accordance with accounting standards. In accounting terminology, they are referred to as provisions, financial guarantees, and insurance liabilities.

As financial estimates are already available for these items, this chapter brings together on-budget liability information to present a complete portfolio view, analyse risk across government, and provide a benchmark against which future movements can be tracked. It also helps contextualise our assessment of off-budget liabilities outlined in **chapter 4**.

In this chapter we first present analysis of the portfolio of on-budget liabilities and then split the portfolio into three distinct categories: government responsibilities, government as guarantor and government as insurer. We then conduct deep dives into each of these categories to better understand their characteristics and components. Finally, as many of these liabilities are very long-term, we explain the significant impact that discount rates and other variables can have on the value of these items.

Portfolio summary

Across government, the total expected cost from on-budget liabilities was £491bn as at March 2022.

Figure 2.A provides a breakdown of expected cost by category. Most costs are government responsibilities; future contingent or uncertain expenditure that the government is legally or contractually committed to incurring because of its past public sector related activities. This represents £465bn of expected cost.

Looking at the types of financial products, tools and commitments used, we find that £316bn of expected cost linked to government responsibilities arises from indemnities¹⁰. A further £139bn of expected cost is linked to legal cases or other dispute processes, with the remainder arising through government guarantees, uncertain costs and mixed liabilities.

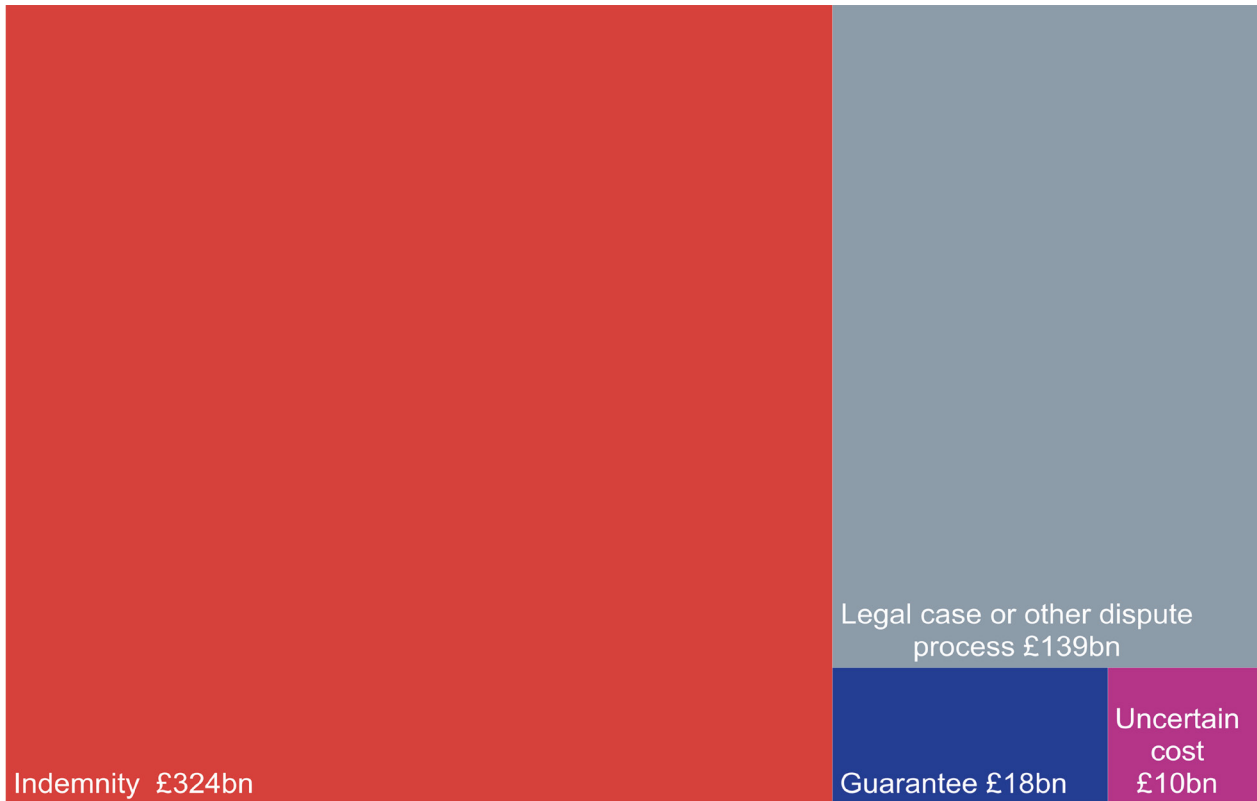
Indemnities are also heavily used when government acts as insurer. These represent 99% of the £8bn expected cost held by government, with the remaining expected cost arising through a mix of legal cases or other dispute processes, uncertain costs and mixed liabilities. Where government acts as guarantor, the entirety of the £18bn expected cost identified arises from financial guarantees.

¹⁰ When receiving and analysing data from departments, these items were categorised into the 21 different financial products, tools and commitments used by government listed in Annex B.

Figure 2.B below sets out the composition of government’s on-budget liabilities when examined purely based on the financial products, tools and commitments used.

This further highlights that the largest components of on-budget liabilities are indemnities (£324bn), legal cases (£139bn) and guarantees (£18bn).

Figure 2.B – On-budget liabilities by financial product and tool¹¹



Government responsibilities

Government responsibilities represent future contingent or uncertain expenditure that the government is committed to incurring because of past activities. These can take the form of a variety of financial products, tools and commitments. The largest on-budget government responsibilities are reported as provisions under accounting standards.

These liabilities are effectively deferred spending commitments. While they are captured on the balance-sheet it is still essential to ensure they are effectively managed and reviewed in a way that

maximises benefits for the taxpayer. The expected cost is sensitive to the assumptions that underpin it. If actual expenditure incurred is substantially different from what was estimated, then this can adversely impact fiscal outcomes.

In addition, in some instances, multiple organisations across government may be developing estimates for the same risk but using different inputs. This makes like-for-like comparisons of such liabilities difficult. To support effective monitoring, reporting and management across the portfolio, we will work with organisations that hold similar

¹¹ Purchaser protection line items (1 entry) account for £0.04bn.

types of risk so that assumptions and analysis are developed in a consistent and standardised manner.

Expected cost of on-budget government responsibilities

Expected cost from on-budget government responsibilities (£465bn) is dominated by two areas:

- decommissioning activities linked to nuclear (£263bn) and oil & gas (£11bn); and
- clinical negligence costs (£128bn).

For this reason, these items are the focus of our analysis. Each reflects a commitment that spans a very long time period, in one case over 100 years, and so expected costs arising from them are significant. Actual annual expenditure on these items includes around £4bn for decommissioning activities for nuclear and oil and gas (relative to an expected future cost of £274bn) and £2bn to £3bn on clinical negligence (relative to an expected future cost of £128bn).

Charging for risk transferred from the private sector

Managing Public Money requires a risk-based fee to be charged, where possible and appropriate, when risk is transferred from the private to the public sector¹². There is very limited scope to charge for government responsibilities because they are, by their nature, a consequence of public sector activity. For this reason, our analysis of the government's scope for charging for risk is focused on its activities as insurer or guarantor.

Factors influencing the expected cost of on-budget government responsibilities

Due to their size and long-term nature, the expected cost of government responsibilities is sensitive to changes in underlying assumptions. Examples of factors that can influence expected cost:

- **Discount rates** – applying an assumption to reflect the time value of money will have a compounding effect on long-term liabilities that can result in significant changes¹³.
- **Timing of cashflows** – in most cases, there is significant uncertainty regarding when payments will be required, and costs are sensitive to changes in cashflow patterns.
- **Inflation and economic uncertainty** – the size and scope of payments required will change over time and can be influenced by economic inflationary factors.
- **Life expectancy** – in some cases, individuals may be entitled to payments for the remainder of their life, and so, the expected future spend is influenced by longevity.

These factors are estimated by setting assumptions based on historical information and future expectations which can prove to be inaccurate. Consequently, actual future expenditure could be materially different to what is forecast and this could result in unplanned expenditure impacting the government's balance-sheet. There is substantial uncertainty around expected cost due to these assumptions, which

¹² www.gov.uk/government/publications/managing-public-money

¹³ Discount rates and the impact they can have on the value of government responsibilities and the analysis underpinning this report are examined in greater detail later in this chapter.

should be updated as new trends are observed in the data. It can therefore take many years for new trends to be identified and reflected in estimates.

Government departments highlight the sensitivities of their expected costs to changes in assumptions, but the methodology and inputs they use are often not aligned. This makes like-for-like comparisons difficult and risks different approaches being used to examine similar areas of risk.

To ensure expected costs for government responsibilities with similar characteristics

use consistent assumptions and approaches, we will work with government departments to standardise and share best practice. Reflecting on the valuable insight gained from the nuclear decommissioning costs review on this topic (case study below), we will explore opportunities to publish further reports on the management of government's largest responsibilities.

Case studies

The following case studies discuss the largest government responsibility items in terms of expected future costs.

Clinical negligence claims (expected cost £128bn)

The Department of Health and Social Care (DHSC) and the devolved administrations provide for future costs in cases where they, or relevant NHS providers, are the defendant in legal proceedings, brought by claimants seeking damages for the effects of alleged clinical negligence. NHS Resolution, an arm's-length body of DHSC, handles claims relating to the NHS in England.

Claims can take many years to be reported and settled. Settlement awards can include both lump sum payments and a commitment to pay a regular stream of money for the rest of a claimant's life. The stream of payments is typically paid annually and is intended to cover a claimant's care costs. These payments can continue well over 50 years into the future and are normally linked to an index of wages of care professionals.

The expected cost is calculated by projecting future expenditure using historical claim patterns and trends. A detailed explanation of the methodology is available in NHS Resolution's accounts¹⁴.

Clinical claims costs are largely funded on a pay-as-you-go basis whereby outgoings each year are met via contributions collected from NHS Trusts' annual budgets.

Whilst the aggregate accrued future cost is relatively high, payments will be made over a long time horizon, with 90% of the costs expected to be paid beyond 5 years. Current annual expenditure is around £2bn to £3bn.

NHS Resolution's annual accounts describe the sensitivities of the provision to a number of assumptions. The accounts also outline that alternative reasonable assumptions (withstanding changes to the discount rates) could lead to the provision being valued higher or lower by at least £20bn.

The Government Actuary's Department supports NHS Resolution on a number of different workstreams, including provisioning (forecasting the ultimate cost of claims), cashflow projection, budget setting and pricing of member level contributions.

14 resolution.nhs.uk/wp-content/uploads/2022/07/NHS-Resolution-Annual-report-and-accounts-2021-22-Access.pdf - note that NHS Resolution's accounts also provide information on additional non-clinical claims which are captured as a separate item in our analysis.

Nuclear Decommissioning (expected cost £263bn¹⁵)

We have carried out a separate detailed review of nuclear decommissioning costs¹⁶ and provided recommendations to better monitor and manage this financial risk.

Most of the cost arises from the Nuclear Decommissioning Authority (NDA), which is the government body responsible for decommissioning the first generation of nuclear sites. These 17 sites include nuclear power stations, research centres and fuel-related facilities. The largest and most complex site is Sellafield.

Other major contributors to this liability are the Ministry of Defence (MOD), responsible for decommissioning costs related to the Defence Nuclear Programme, and the Nuclear Liabilities Fund (NLF), responsible for meeting the costs of decommissioning the second generation of nuclear sites.

The size of the nuclear decommissioning liability reflects the expected future costs in relation to decommissioning activity, spanning over 100 years. This means actual annual expenditure is much lower than the total liability as noted earlier in this chapter.

As an arm's-length body of the Department for Energy Security and Net Zero (DESNZ), the NDA is funded through government spending, as well as some income from commercial activity. In 2021/22, the department funded £2.8bn of decommissioning spend with £0.7bn funded through commercial income. The MOD funds its decommissioning activity entirely through its departmental budget.

The NLF instead holds assets against its liabilities. Its fund is currently deemed to be sufficient, meaning that if future experience matches current expectations, government will not have to contribute any additional funds. It is backed by a government guarantee, meaning that government is responsible for making up any shortfalls.

Beyond the future costs disclosed here, nuclear decommissioning represents a risk to government due to its inherent uncertainty. Where government is responsible for funding nuclear decommissioning, there is the risk that the cost of that decommissioning will become higher than expected. There are several sources of this risk that are shared across different nuclear activities. This includes uncertainty in predicting and valuing future costs, inflation, workforce, timing, technological change, interdependencies, and regulatory change. Beyond these cross-sector risks to the costs, there are other risks specific to the nuclear activity being undertaken in each area.

15 The CLCC Nuclear Decommissioning Cost Review paper has a total estimated cost to government of £257bn, which includes c.£5bn of offsetting NDA assets, and does not include British Energy and UK AEA decommissioning costs c.£1bn.

16 www.ukgi.org.uk/2023/11/02/clcc-thematic-review-cross-government-nuclear-decommissioning-cost/

Government as guarantor

A financial guarantee is an agreement that the government will repay a debt on behalf of a borrower to a lender if the borrower defaults on its obligations. Government acting as guarantor uses financial guarantees as a non-spending mechanism to unlock private capital by reducing the risks of transactions. The application of a government-backed guarantee can allow certain transactions to take place, for example the delivery of major infrastructure projects that uses new technologies to address climate change.

Expected cost of government as a guarantor

The on-budget liabilities arising from government's role as guarantor, covering financial guarantees to the private sector, represented £18.4bn of expected cost as at March 2022, or 4% of the total expected cost of on-budget liabilities.

£15.8bn of this was in relation to COVID-19 support schemes under the former Department for Business, Energy and Industrial Strategy (BEIS). These schemes were the:

- Bounce Back Loan Scheme (BBLs);
- Coronavirus Business Interruption Loan Scheme (CBILs);
- Coronavirus Large Business Interruption Loan Scheme (CLBILs); and
- Recovery Loan Scheme (RLS).

These were established in response to the COVID-19 pandemic and national lockdown in 2020. The government initially launched three government-guaranteed loan schemes (BBLs, CBILs and CLBILs) that provided a lifeline to almost 1.7 million businesses

and delivered £77bn of finance. These schemes were delivered at pace because if government had not acted quickly, there would have been a sharper rise in business insolvencies and subsequent job losses. Following the closure of these schemes to new applicants, a fourth scheme (RLS) was launched in April 2021.

The size of the government's aggregate portfolio of financial guarantees was therefore much smaller before the start of the COVID-19 pandemic than it is currently. It is expected that as these loans are repaid over time, government's exposure (notwithstanding the impact of claims and recoveries) will continue to fall.

Financial guarantees represent the largest category of on-budget liabilities where risk is transferred from the private sector to government. Therefore, a detailed analysis of government's largest financial and international guarantee arrangements – including an analysis on the extent of charging – is included in **chapter 3**. This analysis focuses on guarantees that have an outstanding balance value of £103.6bn, with an associated expected cost of £18bn and highlights the government's use of charging (98.8% when excluding the Bounce Back Loan Scheme) to compensate for the risk it takes on from the private sector.

Case study

The following case study outlines how UK Export Finance (UKEF) offers guarantees to support exporters and charges premiums to cover the costs of this risk and associated administration fees.

UKEF's Export Development Guarantee

UKEF is the United Kingdom's Export Credit Agency (ECA). It exists in order to ensure that no viable UK export fails for lack of finance or insurance, supporting exporters of UK goods, services and intangibles by providing guarantees, direct loans, insurance, and reinsurance against losses. In return, UKEF charges commercial, risk-based premiums to cover the associated cost of risk and administration fees and help it operate at no net cost to the taxpayer. Pricing of UKEF guarantees is either bespoke or carried out in accordance with the Organisation for Economic Co-operation and Development (OECD) *Arrangement on Officially Supported Export Credits*¹⁷.

UKEF offers guarantee products for a range of transaction structures, notably guarantees to commercial banks that are lending to buyers for the purchase of capital goods, services, or intangibles. These facilities can be offered on a secured (e.g. against assets) or unsecured basis. The guarantees offered by UKEF provide counterparties with much-needed liquidity in situations where private market funding is lacking, or they have been declined for capital market financing.

In 2019, the department expanded its support for non-contract-specific exports by offering working capital support through the Export Development Guarantee (EDG). This product was designed to help give companies who export from, or plan to export from, the UK, access to loan facilities for general working capital or capital expenditure projects. As part of the eligibility assessment, UKEF can provide partial guarantees covering up to 80% of the risk to a commercial lender for a maximum repayment term of five years or ten years if the loan is to develop clean growth exports.

The EDG helped to avoid job losses in the airline and manufacturing sectors during the COVID-19 pandemic. To date, around £10.6bn (book value) of liquidity support has been provided to some of the UK's largest employers, including British Airways, Jaguar Land Rover, Nissan, and Rolls-Royce.

Government as insurer

In its capacity as an insurer, government uses a range of financial products and tools to support the private sector in the form of indemnities, insurance, or reinsurance. These are tailored as schemes to achieve specific policy objectives or respond to emerging challenges where government decides to intervene.

Typically, schemes are used to enable the smooth functioning of markets, provide

access to insurance or protect consumers and disadvantaged sub-sets of society. These can have many unique features and dual purposes that extend beyond risk transfer and incorporate wider risk reduction motivations. Such motivations can include:

- **Intervention to enable the smooth functioning of markets** – emerging risks can disrupt and stifle markets which can have direct and second order

¹⁷ www.oecd.org/trade/topics/export-credits/arrangement-and-sector-understandings/

impacts on citizens and the economy. For instance, during the COVID-19 pandemic increased risk caused commercial (re)insurers to withdraw cover which disrupted industries and citizens. *Example schemes: Trade Credit Reinsurance, Film & TV Production Restart Scheme and Live Events Reinsurance Scheme.*

- **Risk removal** – some risks are considered uninsurable by commercial (re)insurance markets. This can be due to the size of the risks and/or the inability to diversify across multiple independent instances of the risks. These risks can limit the level of insurance cover provided to markets and reduce economic activity and investment. Schemes have been developed to provide mechanisms to remove these risks from markets. *Example schemes: Pool Re, Pool Re Nuclear and Nuclear Third-Party Liability.*
- **Risk redistribution and consumer protection** – participants might not have access to affordable insurance cover due to their individual risk characteristics or consumers might not be protected in the event suppliers of services become insolvent. These schemes redistribute the cost of covering the risk across participants in a market or provide a safety net. *Example schemes: Financial Assistance Scheme, Flood Re, Pension Protection Fund and Financial Services Compensation Scheme.*

From these examples, the Financial Assistance Scheme, Trade Credit Reinsurance and Flood Re schemes are recognised as on-budget liabilities, with the remaining examples either captured

as off-budget liabilities in **chapter 4** or not included due to the scope of our analysis. They are referenced here to provide recognisable examples of different motivations for government.

It is possible that the government will need to roll out similar insurance schemes to those outlined above, including at pace during times of crises. Where appropriate, we will support government departments to review these schemes to help inform best practice linked to future charging structures and opportunities for government to disperse or mitigate emerging risks.

Expected cost of government as insurer

The on-budget liabilities arising from government's role as insurer represented £8bn of expected cost, or 2% of total expected cost of on-budget liabilities as at March 2022. Of this £8bn, around three quarters (£6.3bn) relates to the Financial Assistance Scheme. This aids members of defined benefit occupational pension schemes that were wound up or underfunded when their employers became insolvent during the period January 1997 to April 2005 and therefore is a legacy liability with no ongoing accruals.

Case studies

Trade Credit Reinsurance Scheme

The Trade Credit Reinsurance Scheme was set up to support UK companies trading on credit terms during the COVID-19 pandemic. Due to the pandemic, there was an increased risk of company insolvencies, and consequently trade credit insurance became less affordable, reducing UK companies' ability to trade.

Government intervened by taking on c.90% of the risk related to UK trade credit insurance products in return for receiving 90% of the premium. This helped the market continue to function. Government's obligation related to these claims is now winding down following the closure of the scheme. Estimated accrued future cost was reported as £30m as at March 2022.

Flood Re

Flood Re is a joint initiative between the insurance industry and the government. Its purpose is to ensure the availability and affordability of flood insurance for eligible homes and to manage, over its lifetime, the transition to risk-reflective pricing for household flood insurance.

In order to do this, Flood Re provides reinsurance cover at a subsidised fixed rate to cedants. The company finances this primarily through a levy on UK household insurers. This mechanism effectively redistributes the premium costs that would be charged to high flood risk households by spreading a proportion of it across the wider home insurance market.

In December 2021, Flood Re was classified by the Office for National Statistics (ONS) as a central government public body. Therefore, its insurance liabilities are consolidated into the financial statements of the Department for Environment, Food and Rural Affairs (DEFRA) together with its assets, which exceed the value of its liabilities. Flood Re is a mutual reinsurer financed entirely through the levy on UK household insurers with no government guarantee.

Data sources and limitations

This chapter brings together data from 17 departments' annual report and accounts, showing the position as at March 2022. At the time of carrying out the analysis for this report, some but not all departments had published their 2022/23 accounts. For consistency, we have continued to present data as at March 2022, and have noted any known or expected material changes in results to March 2023.

Other schemes and exclusions

Many of the schemes covering government's role as insurer do not feature as on-budget liabilities as at March 2022. There are two key reasons for this:

- They are disclosed as contingent liabilities or remote contingent liabilities in accordance with accounting standards due predominantly to the low likelihood of government incurring costs from the obligation. They are therefore included in the analysis of off-budget liabilities in **chapter 4**, for example Pool Re¹⁸ (which provides insurers with cover for certain property-related terrorism risks using a government guarantee) or the Live Events Reinsurance Scheme (introduced by the then Department for Digital, Culture, Media & Sport (DCMS) during the COVID-19 pandemic to support live events, although the risk had expired by March 2023).

- They are not consolidated into any of the 17 departments' annual report and accounts included in this analysis. This is the case for the Pension Protection Fund (PPF), which protects people with a defined benefit pension in the case of employer insolvency after April 2005. The PPF is financed entirely through the levy on eligible defined benefit pension schemes. Similarly, the Financial Services Compensation Scheme (FSCS), which provides protection for bank deposits, also does not feature.

Application of expected cost

The principal measure used in this analysis is estimated accrued future cost (expected cost), which was explained in **chapter 1**. Where appropriate, estimates of annual expenditure are also provided for context. As outlined in **chapter 1**, the expected cost does not take into account any income received through fees or premiums charged by government (e.g. when taking on risk from the private sector) or any assets (or contingent assets) held against the liabilities. Where appropriate, estimates of annual expenditure are also provided for context.

Even though a single value is presented for expected cost, corresponding to the value recognised in financial statements, it should be recognised that future expenditure is subject to considerable uncertainty, especially over the long time periods relevant to many of the larger items. Outturn could differ substantially to the values presented.

18 Following an ONS reclassification, Pool Re will be consolidated into the HM Treasury group accounts from March 2023.

Impact of discount rate and changes to March 2023

Many of the larger items described in this chapter represent spending commitments for many years into the future. Such items are adjusted to reflect the time value of money (discount rate), in that future payments are discounted back to the present time. This adjustment *significantly* affects the value placed on these commitments.

Definition: discount rate

The discount rate is a financial assumption representing government's view of the time value of money. It allows us to determine the present value of future payments, and in effect, how much money would need to be set aside now to meet a specified liability in the future. The discount rate used for accounting purposes is updated each year.

The compounding effect of applying discount rates over multiple years means that small changes to the assumptions can result in substantial changes to the total value placed on expected future costs. Changes to the discount rate do not affect estimated future annual expenditure but can significantly affect the value placed on that expenditure now.

When considering the estimated accrued future cost set out earlier in this chapter, it is important to bear in mind how they are affected by the discount rates used each year, for example:

- Expected cost in respect of clinical negligence increased from £85bn at March 2021 to £128bn at March 2022. Almost all of the increase was attributed to a reduction in the discount rates used.
- While DHSC has not yet published its 2022/23 annual report and accounts, NHS Resolution's 2022/23 annual report and accounts shows that its clinical negligence provision decreased from £128bn at March 2022 to £69bn at March 2023, with the change in discount rate reducing the provision by £75bn (there were some partially offsetting increases).
- The NDA and MOD have also published their 2022/23 annual report and accounts, showing broadly similar impacts from the change in discount rate¹⁹. If you were to use the relevant data from their respective 2023 accounts, the nuclear decommissioning costs decrease from £263bn at March 2022 to £136bn at March 2023. The total impact of the change in discount rate is around £150bn, with some partially offsetting increases.

¹⁹ See Annex D for further information regarding changes to the discount rates.

There is often a link between the discount rates used for accounting purposes (which broadly reflect the cost of government borrowing) and future inflation expectations. The strength of this link will depend on the nature of the future government commitment. Increases in discount rates reduce the size of accrued future cost whilst increases to inflation expectations will increase the value of accrued future cost. The extent to which changes to these underlying drivers are reflected in financial accounts will depend on the approach to setting assumptions, and the timing of when the assumptions are updated.

The implication of the changes to discount rates for government decision making is outside the scope of this report and relates to wider decision making influenced by the macro-economic environment. For the purposes of this report, the accrued future costs, where discounted, enable different commitments to be compared on a market consistent basis which then helps us identify the most material items and understand the relative size of different contingent liabilities. When the sizes of items change across reporting periods, it is important to recognise the element of that change that is driven by discount rate movements versus those that are driven by changes to the underlying commitments.

Chapter 3: Material Financial Guarantees

Summary

- In this chapter, we examine government's largest on-budget financial and international guarantees which interface with the private sector, multilateral development banks (MDBs) and foreign sovereigns. These guarantees have been aggregated into portfolios based on their underlying policy objectives (see **figure 3.B**). We have analysed each portfolio to assess its performance to date, outlook, and the extent to which charging has been applied to compensate government for the risk it undertakes.
- The aggregate outstanding balance or value of guarantees covered in this chapter is £103.6bn as at 31 March 2022, with an associated expected cost of £18.0bn. 87% of this expected cost is driven by COVID-19 schemes. This expected cost value, compared to the £18.4bn stated in **chapter 2** excludes some smaller items that are not covered in this chapter.
- Throughout this report we have used the terminology 'expected cost' which in this chapter reflects the 'expected credit losses' that could potentially fall to government from the respective schemes and guarantees. This does not take into account any income from fees or premiums charged.
- We have separately analysed the extent to which charging has been used to cover expected cost and administration. CLCC analysis has determined that £61.5bn (61%) of all government issued financial guarantees charged some form of fee or premium (in line with their respective policies). For example, guarantees issued by UK Export Finance charge premiums to cover expected costs plus administration fees, which collectively help it operate at no net cost to the taxpayer. This proportion increases to 98.8% when excluding the Bounce Back Loan Scheme (BBLs).
- The CLCC will undertake further work with government departments that will explore how government could manage credit risk where new guarantee schemes are required in crises or to compressed timelines. The CLCC will also build on the insights gathered in this chapter to explore whether innovative new structures can be used to better achieve government's policy objectives while maximising value for money.

Figure 3.A – Estimated accrued future cost of on-budget liabilities as at March 2022

Type	On-budget		Off-budget £bn	Total	
	£bn	%		£bn	%
Government responsibilities	465	94%	15	480	93%
Government as insurer	8	2%	6	14	3%
Government as guarantor	18	4%	2	20	4%
Total	491	100%	23	514	100%

Introduction

Financial guarantees represent the largest category of on-budget liabilities where risk is transferred from the private sector to government. As previously mentioned, through government's role as guarantor, £18.4bn of expected cost can be attributed to financial guarantees to the private sector, MDBs (i.e., international financial institutions established by two or more sovereign states, which are also the shareholders e.g., World Bank, IMF), and foreign sovereigns. This chapter explores government's most material on-budget financial guarantees (outstanding balance, £103.6bn) in greater detail to assess whether charging is being used appropriately to compensate government for taking on risk; and understand the performance and outlook for government's most material guarantees.

Firstly in this chapter we will provide an overview of this portfolio of guarantees and outline its key features. We then assess the extent to which government is charging fees or premiums to take on risk from the private sector, and finally we provide detailed analysis of government guarantees across the following portfolios: COVID-19 schemes, Export Finance Guarantees, International Development and Foreign Sovereign Guarantees, the government's Housing Guarantee Portfolio, and the ENABLE schemes.

Note on data sources and measure of cost

The information underpinning the analysis and assessment of portfolio performance in this chapter has been gathered from departments' annual report and accounts and/or through engagement with delivery partners. In particular, data is taken from 2021/22 accounts, showing the position as at March 2022. At the time of carrying out the analysis for this report, some but not all departments had published their 2022/23 accounts. For consistency, we have continued to present data across the portfolio as at March 2022. Furthermore, this chapter notes any known or expected material changes to these positions during the period to March 2023.

Portfolio summary

The largest line items relate to COVID-19 support schemes, which when combined, account for 60% of the outstanding balance and 87% of the expected cost of the total material guarantees portfolio. These were government-guaranteed loan schemes that provided a lifeline to almost 1.7 million businesses and delivered £77bn of finance following the COVID-19 pandemic and national lockdown. Of these schemes, the

BBLs is the largest single portfolio item of the outstanding balance (38%) and is the majority of the expected cost (78%) of the total material guarantees portfolio. The relatively high expected cost for this scheme is mainly because the scheme was designed to provide liquidity to small and less sophisticated businesses during the COVID-19 lockdown, combined with uncertainty around the extent to which these businesses would be able to recover. Loans under this scheme are unsecured.

In contrast, all the other guarantees and guarantee schemes listed in **figure 3.B** can be characterised as business-as-usual as these guarantees and schemes typically have a longer planning horizon, allowing more time for thorough structuring to improve the risk profile. This is reflected in the lower expected cost for these guarantees and schemes. All material guarantees schemes are managed appropriately with sufficient controls in place.

As non-business-as-usual guarantees usually have a higher risk profile, we will work with government departments to produce guidance on how to manage credit risk when delivering schemes in crises or to compressed timelines.

Figure 3.B – Financial and international guarantees portfolio summary as at March 2022

Guarantee Scheme		Outstanding Balance – (£bn)	Expected Cost – (£bn) ²⁰	Fee or Premium Charged	Domestic or International Guarantees
COVID-19 Schemes	Bounce Back Loan Scheme (BBLS)	38.9	14.0	No	Domestic
	Coronavirus Business Interruption Loan Scheme (CBILS)	18.5	1.4	Yes	Domestic
	Coronavirus Large Business Interruption Loan Scheme (CLBILS)	2.6	0.1	Yes	Domestic
	Recovery Loan Scheme (RLS)	2.6	0.3	Yes	Domestic
UK Export Finance Guarantees	UK Export Finance (UKEF) Guarantee Portfolio	34.0	2.1	Yes	Domestic and International
International Development and Foreign Sovereign Guarantees	Foreign, Commonwealth & Development Office (FCDO) Guarantee Portfolio	0.9	<0.1	No	International
Housing Guarantee Portfolio	Affordable Housing Guarantee Scheme (2013 and 2020)	3.5	<0.1	Yes	Domestic
	Private Rented Sector Guarantee Scheme	1.5	0.1	Yes	Domestic
	Mortgage Guarantee Scheme (2013 and 2021)	0.6	<0.1	Yes	Domestic
ENABLE Schemes	ENABLE Guarantee Scheme (SMEs)	0.2	<0.1	Yes	Domestic
	ENABLE Build Scheme (SME Housebuilders)	0.3	<0.1	Yes	Domestic
Total		103.6	18.0	–	–

²⁰ Expected cost is gross of any fees received and is equivalent to Expected Credit Loss in this context.

Government's remuneration for the risk undertaken

Our analysis has determined that £61.5bn (61%) of all government issued financial guarantees charged some form of fee or premium. That percentage increases to 99% if you exclude the COVID-19 BBLs, which is not comparable to other guarantee schemes as it was established specifically to provide loans to micro and small businesses, with a streamlined application process designed to deliver finance quickly to borrowers at the height of the COVID-19 crisis.

Where fees or premiums have been charged, irrespective of whether government shares in those fees, they have not been charged in a uniform way. This is often due to government using different forms of guarantee arrangements to support a broad range of sectors across domestic and international markets. Additionally, these are all subject to different forms and levels of control. For example, fees on certain types of financial guarantees issued by UK Export Finance must comply with the *OECD Arrangement on Officially Supported Credits*²¹ and the World Trade Organization (WTO) *Agreement on Subsidies and Countervailing Measures*²² but would also be required to satisfy internal financial targets.

Conversely, there are examples in government where fees are not charged and this is mainly found with international financial guarantees (e.g. guarantees to support World Bank lending) administered through the FCDO. In these cases, an estimate of the cost of risk (i.e. expected

cost) is given in the accounts but the value for money is achieved through wider policy aims and outcomes.

In summary, having assessed the government's portfolio of financial guarantees, all reasonable opportunities to charge for risk have been taken, where doing so does not undermine policy objectives. Furthermore, guidance to ensure that these charges should normally be at least enough to compensate for the expected cost is documented within HM Treasury's *Contingent Liabilities Approval Framework*²³ and UKGI CLCC's guidance note on *Charging for Guarantees and Indemnities*²⁴. Through its advisory work the CLCC actively supports, and will continue to help, departments to assess and evaluate new proposals, which includes appropriate charging mechanisms.

Performance of material guarantees and guarantee schemes

COVID-19 business loan guarantee schemes

In response to the COVID-19 pandemic and national lockdown in 2020, the government launched three government-guaranteed loan schemes that provided a lifeline to almost 1.7 million businesses and delivered £77bn of finance. These schemes were delivered at pace because if the government had not acted quickly, there would have been a sharper rise in business insolvencies and subsequent job losses. All three schemes closed to new applications in March 2021. Following the closure of these schemes, a

21 www.oecd.org/trade/topics/export-credits/arrangement-and-sector-understandings

22 www.wto.org/english/tratop_e/scm_e/subs_e.htm

23 www.gov.uk/government/publications/contingent-liability-approval-framework

24 www.ukgi.org.uk/2023/06/02/clcc-guidance-charging-for-guarantees-and-indemnities

fourth scheme was launched in April 2021. All four schemes are administered by the British Business Bank (BBB). Under the schemes, lenders received a government-backed full or partial guarantee (depending on the scheme) against the outstanding facility, with the borrower remaining fully liable for the debt.

- **Bounce Back Loan Scheme (BBLs):**

BBLs was introduced to support UK-based small and medium-sized enterprises (SMEs), micro businesses and other businesses requiring smaller loans of up to a maximum of £50k. The accredited lenders received a government-backed full guarantee (100%) against the outstanding balance of the facility.

- **Coronavirus Business Interruption Loan Scheme (CBILs):**

CBILs was targeted at smaller businesses with an annual turnover of less than £45m, providing up to a maximum loan of £5m. The scheme gave the accredited lenders a government-backed partial guarantee (80%) against the outstanding balance of the facility.

- **Coronavirus Large Business Interruption Loan Scheme (CLBILs):**

CLBILs was aimed at larger businesses with an annual turnover in excess of £45m, providing up to a maximum loan of £50m. Facilities in excess of £50m up to £200m, were available – subject to lenders having additional accreditation and additional eligibility criteria on the loan itself. The accredited lenders received a government-backed partial guarantee (80%) against the outstanding balance of the facility.

- **Recovery Loan Scheme (RLS):**

RLS was launched in April 2021 and

is scheduled to close on 30 June 2024. It was aimed at ensuring that UK businesses of any size could continue to access loans and other kinds of finance as they grew and recovered from the disruption of the pandemic. The lender receives a government-backed partial guarantee (70% or 80%) against the outstanding balance of the facility.

Performance

As at March 2022, over three-quarters (82.8%) of outstanding **BBLs loans** (of £38.9bn) were performing, and about 7% (£3.28bn) of total drawn value (£46.6bn) fully repaid. Non-performing loans stood at 8.3% (£3.22bn), 4.9% (£1.89bn) and 4.1% (£1.6bn) of loans outstanding as at March 2022 for arrears, defaults and outstanding claims respectively.

The majority (97.5%) of outstanding **CBILs loans** (of £18.5bn) as at March 2022 were performing, and 16.7% of drawn value fully repaid. Non-performing loans stood at 1.2% (£0.22bn), 1.1% (£0.20bn) and 0.3% (£0.06bn) of loans outstanding as at March 2022 for arrears, defaults and outstanding claims respectively.

The **CLBILs portfolio** has also performed well with limited signs of distress. The majority of loans outstanding as at March 2022 were performing (99.6%), and 30.7% of drawn value fully repaid. Non-performing loans were below 1% of outstanding balance (loans in arrears only).

The **RLS portfolio** performed well with the majority of loans outstanding as at March 2022 being up to date with payments (97.4%), and less than 1% of drawn facilities fully repaid. Non-performing loans were below 1% of outstanding facilities (loans in arrears and default only).

Definitions: Arrears, default, and outstanding claims

Arrears is outstanding payment after the due date has passed, which relates to interest, the principal loan, or both.

Default is the failure to make a required payment (interest and/or principal) on a loan, as and when due.

Outstanding claims are unsettled due payments on a loan, including the principal amount and all interest accrued at a given point in time.

Figure 3.C – Portfolio performance as at March 2022

Summary	BBLs (March 2022)	CBILS (March 2022)	CLBILS (March 2022)	RLS (March 2022)
Guaranteed outstanding loan balance (£bn)	38.9	18.5	2.6	2.6
Outstanding Claims (£bn)	1.6	<0.1	0.0	0.0
Performing loans (% of outstanding loans) ²⁵	83%	98%	99%	97%
Claims settled (% of loans drawn)	<1%	<1%	<1%	0%
Arrears (% of outstanding loans)	8%	1%	<1%	<1%
Defaults (% of outstanding loans)	5%	1%	0%	<1%
Outstanding claims (% of outstanding loans)	4%	<1%	0%	0%

25 Calculations are based on the “on schedule” outstanding balance generated by the portal and not one reported by the respective accredited lenders. <https://www.gov.uk/government/publications/covid-19-loan-guarantee-schemes-repayment-data/covid-19-loan-guarantee-schemes-repayment-data-as-at-31-march-2022>

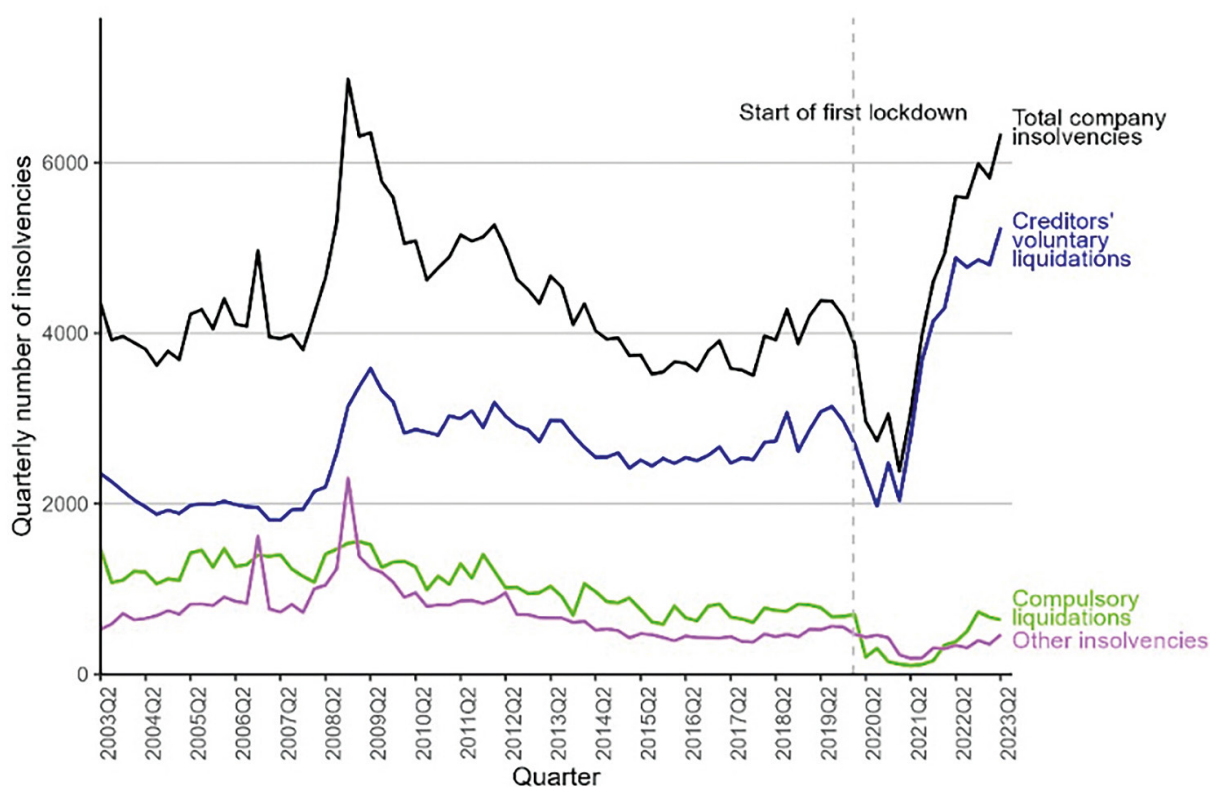
Outlook: UK Small and Medium-Sized Enterprises (SME) and Corporate Sector

UK SME and corporate creditworthiness is under pressure amid high inflation, increasing interest rates and supply chain disruptions. This could result in an increase in the crystallisation of the government's COVID-19-related business loan guarantees.

Recent indicators suggest a deterioration in the creditworthiness of UK businesses that is likely to feed through into increased

default rates, particularly for SME loans. Between 1 April and 30 June 2023 (Q2 2023), there were 6,342 (seasonally adjusted) registered company insolvencies. After seasonal adjustment, the number of company insolvencies in Q2 2023 was the highest since Q2 2009, 9% higher than in Q1 2023 and 13% higher than in Q2 2022. The number of compulsory liquidations also increased but remained slightly lower than levels seen prior to the COVID-19 pandemic.²⁶

Figure 3.D – Company Insolvencies in England and Wales between Q2' 2003 and Q2' 2023 (seasonally adjusted)



Source: *The Insolvency Service*

26 <https://www.gov.uk/government/statistics/company-insolvency-statistics-april-to-june-2023/commentary-company-insolvency-statistics-april-to-june-2023>

Outlook: BBLs, CBILs and CLBILs Portfolios

Delinquencies could increase amid rising interest rates and inflation, resulting in an increasing share of companies experiencing some form of distress and impairment of their debt serviceability.

Expected costs on CLBILs are anticipated to be materially lower than the BBLs, CBILs and RLS schemes due to several factors: a) the smaller size of the portfolio; b) a focus on medium and large businesses which are typically more resilient to exogenous shocks; c) the requirement that CLBILs facilities not be subordinated to any other borrowing; and d) the nature and/or availability of the collateral that such businesses can generally post (which would lead to better recoveries in the event of default).

Defaults are most likely to be concentrated at BBLs portfolio level due to the lower degree of financial headroom of micro and small businesses in comparison to large SMEs and corporates, and the large exposure of the BBLs portfolio (i.e. 62% of total outstanding balance of COVID-19 business loans) in comparison to the CBILs (30%), CLBILs (4%) and RLS (4%) portfolios, as shown in **figure 3.C** above.

Since the reporting date of March 2022, there have been a few material changes to the respective COVID-19 related business loan guarantee portfolios. The outstanding balances have been further reduced during the period to 30 June 2023, with exposures decreasing by 39% (£15bn), 45% (£8.3bn) and 62% (£1.6bn) on the BBLs, CBILs and CLBILs loans respectively.

£20.4bn (85.3%) of outstanding **BBLs loans** (£23.9bn, as at June 2023) were performing, and £5.6bn (12%) of total drawn value (£46.6bn) fully repaid. Non-performing loans stood at 8.3% (£1.97bn), 2.2% (£0.53bn) and 4.2% (£1bn) of loans outstanding as at June 2023 for arrears, defaults, and outstanding claims respectively. Claims settled stood at £6.9bn (14.8%) of total drawn value and £1.65bn (3.5%) of total drawn value flagged as suspected fraud by lenders.

£9.6bn (94.3%) of outstanding **CBILs loans** (£10.2bn, as at June 2023) were performing, and £8.7bn (33%) of total drawn value (£25.9bn) fully repaid. Non-performing loans stood at 2.5% (£0.25bn), 2.2% (£0.22bn) and 1% (£0.11bn) of loans outstanding as at June 2023 for arrears, defaults, and outstanding claims respectively. Claims settled stood at £0.5bn (1.8%) of total drawn value and £40m (0.2%) of total drawn value flagged as suspected fraud by lenders.

£958m (97.3%) of outstanding **CLBILs loans** (£985m, as at June 2023) were performing, and about £3bn (66.7%) of total drawn value (£4.5bn) fully repaid. Non-performing loans stood at 0.6% (£5.5m), 0.3% (£2.7m) and 1.9% (£19.1m) of loans outstanding as at June 2023 for arrears, defaults, and outstanding claims respectively. Claims settled stood at £18m (0.4%) of total drawn value.

Figure 3.E – Performance update as at 30 June 2023

Summary	BBLs (June 2023)	CBILs (June 2023)	CLBILs (June 2023)
Guaranteed outstanding loan balance (£bn)	23.9	10.2	<1.0
Outstanding Claims (£bn)	1.0	0.1	<0.1
Performing loans (% of outstanding loans)²⁷	85%	94%	97%
Claims settled (% of loans drawn)	15%	<2%	<1%
Arrears (% of outstanding loans)	8%	2%	<1%
Defaults (% of outstanding loans)	6%	3%	2%
Outstanding claims (% of outstanding loans)	4%	1%	2%

27 Calculations are based on the “on schedule” outstanding balance generated by the portal and not one reported by the respective accredited lenders. <https://www.gov.uk/government/publications/covid-19-loan-guarantee-schemes-repayment-data/covid-19-loan-guarantee-schemes-performance-data-as-at-30-june-2023#headline-figures-aggregated-figures-across-all-schemes>

Export Finance Guarantees

UK Export Finance (UKEF) is the United Kingdom’s Export Credit Agency (ECA). It exists to ensure that no viable UK export fails for lack of finance or insurance, supporting exporters of UK goods, services and intangibles by providing guarantees, direct loans, insurance, and reinsurance against losses. UKEF charges premiums to cover expected cost and the cost of administration.

Definitions: Pricing Adequacy Index (PAI) and Premium to Risk Ratio (PRR)

Pricing Adequacy Index: this measure tests whether over a *rolling three-year period*, actual and forecast premiums will cover, and exceed, the cost of doing business (i.e. cover all its risk and operating costs).

Premium to Risk Ratio: this measure ensures that *in each financial year*, UKEF charges enough premium to cover the cost of risk, together with a sufficient margin to contribute a material amount to administrative costs. The target for this measure is at least 1.35 times greater than the agreed level of expected and unexpected loss measured for each transaction at the time of pricing.

Figure 3.F – Summary of UKEF key portfolio characteristics as at March 2022

Exposure		Risk Coverage Ratios		Key Concentrations	
Amount at risk (gross/net) ²⁸	Expected Cost (gross/net)	Pricing Adequacy Index	Premium to Risk Ratio	Regions	Industries
£34bn/£28bn (Maximum Commitment Limit: £50bn)	£2.07bn/£1.03bn	1.57 (Floor: 1.00 over three years)	2.03 (Target: no less than 1.35 per year)	Europe (45% of net AAR) Middle East and Africa (42% of net AAR)	Aerospace, construction, and energy & power (38%, 16% and 14% of net AAR respectively)

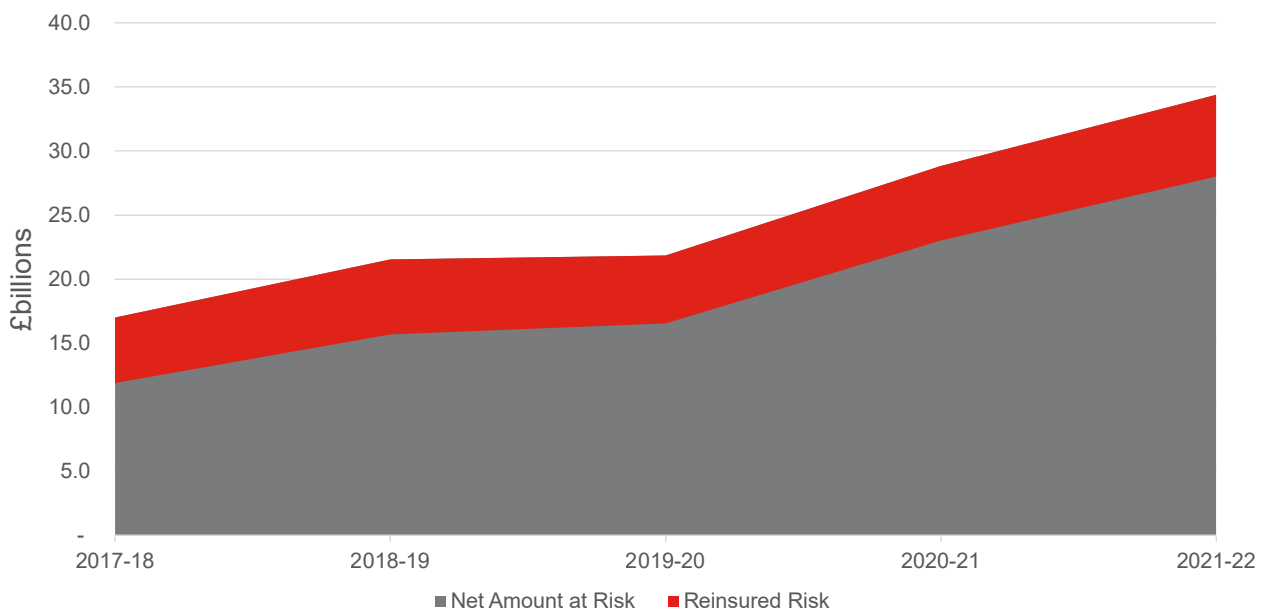
28 The net AAR is the gross AAR less the combination of ECA-to-ECA co-financing and private market reinsurance arrangements.

Performance

As at 31 March 2022, UKEF's gross total exposure (also known as Amount at Risk (AAR))²⁹ was £34.4bn. The department incorporates safeguards to manage risks (notably credit and market risks) in its portfolio which is achieved principally through: a) prudent risk management and controls (covering elements such as credit assessment processes, delegated credit authorities and risk measurement and monitoring, which are all subject to external oversight); and b) active portfolio management techniques.

The latter uses a combination of ECA-to-ECA co-financing and private market reinsurance arrangements resulting in a net AAR of £28bn. When considering double default risk³⁰, comfort should be taken from the fact that the likelihood of both the primary counterparty and reinsurer defaulting under these arrangements is expected to be low given that UKEF requires all insurers, including general insurers and Lloyd's syndicates, to be rated at a minimum 'A-' equivalent credit agency rating – implying a low probability of default³¹.

Figure 3.G – Five-year AAR timeseries showing UKEF's gross AAR and net AAR in £billions (includes portion of reinsured risk – in red)



29 AAR is equivalent to the accounting definition of a "Contingent Liability". A contingent liability is a potential obligation/liability that may arise depending on the outcome of a specific event in the future.

30 Double default occurs when the obligor/counterparty and guarantor or supplier of credit insurance fail to meet their financial obligations.

31 As an additional check, UKEF also requires insurers to have maintained sound capital and solvency ratios as well as "underwriting disciplines" during the COVID-19 pandemic.

Most of UKEF's credit exposure is made up of medium to long-term finance. In terms of overall AAR, around 17% of UKEF's portfolio as at March 2022 is expected to run off in less than a year, with around 58% expiring within 4 years.

As at March 2022, UKEF's gross portfolio expected cost was around £2.07bn or c.6.0% of gross AAR (net portfolio expected cost of £1.03bn or c.3.7% of net AAR) and comprised of £740m of insurance contracts and £287m of financial guarantees. As stated in **chapter 2**, UKEF charges commercial premium rates to cover its expected losses plus its administration cost, which collectively help it operate at no net cost to the taxpayer.

Credit quality, geographic, and sectoral concentrations

UKEF has a defined risk limit for each country and territory, working within an agreed framework set by HM Treasury to ensure that it operates at no net cost to the taxpayer. Within this framework, UKEF has limited control over the geographical or sectoral composition of its portfolio since its mandate is to ensure that no viable UK

export fails for lack of finance or insurance. The portfolio is well diversified in terms of geographical and sectoral composition. As at March 2022, aerospace construction, energy and power, and transportation industries account for 81% of UKEF's portfolio (per net AAR).

As set out in **figure 3.H** below, geographically, the department's exposure (net AAR) was largely to the Middle East and Africa, peaking at 61% in 2020 (£14.1bn), with a five-year average of 50%. Following the introduction of the Export Development Guarantee (EDG) in 2020³², net AAR over the last two financial years has seen a shift towards Europe (being dominated by EDGs to UK Corporates) – 45% of net AAR as at March 2022 compared to 20% five years ago.

In terms of credit quality of the portfolio, investment grade rated exposures (BBB- and above) dropped from 34% to 14%, whilst the proportion of sub-investment grade rated exposures (BB+ to BB-) and (B+ and below) increased from 41% to 45% and 25% to 41%, respectively (weighted average portfolio rating is B+)³³.

Figure 3.H – Regional breakdown of net AAR

Region/FYE	End-March 2018	End-March 2019	End-March 2020	End-March 2021	End-March 2022	5-Year Average
Americas	14%	11%	8%	4%	4%	8%
Asia & Pacific	21%	17%	15%	8%	9%	14%
Europe	20%	16%	16%	43%	45%	28%
Middle East and Africa	45%	56%	61%	45%	42%	50%

32 The EDG allows customers to access high-value loan facilities (≥£500m) for general working capital or capital expenditure purposes and involves UKEF guaranteeing up to 80% of finances provided by a commercial lender.

33 Ranges from 'AAA' (reflecting the strongest credit quality and lowest Probability of Default) to 'D' (reflecting the lowest credit quality and highest Probability of Default) in line with S&P and Fitch credit rating scales.

This trend is partly attributed to significant downgrades of counterparties, which occurred during 2020/21, due to the impact of the COVID-19 pandemic and resulting lockdown.³⁴

Claims

Claims paid by UKEF were relatively low in the period between 2014 and 2020 before the onset of COVID-19 (£2m in 2017/18, £0 in 2018/19, and £8m in 2019/20) in comparison to 2020/21 and 2021/22 – during the pandemic and the year after, respectively. There was a significant increase to £107m in 2020/21. During 2021/22, the value of claims paid reached £103m, spread across 188 unique claims. This rise in claims aligns with the impact of COVID-19 on the financial condition of counterparties, e.g. travel restrictions resulted in some airlines defaulting or restructuring their obligations to prevent insolvency.

The current claim levels are ~2.5x lower than those paid in the immediate financial year after the 9/11 attacks (following the significant decline in international passenger travel). Furthermore, net premium income (after ceding to reinsurers) in 2021/22 was £441m (2020/21: £330m). Notwithstanding the increase in total amount of claims, the annual claims payments have been more than covered by the premium income with no additional cost to the taxpayer.

Outlook

Pressures which could affect UKEF's portfolio include increased claims as counterparties face a combination of rising interest rates, supply chain pressures, and inflationary pressures.

UKEF's portfolio predominantly comprises long-dated, emerging market risks (both sovereign and corporate), with a growing focus on supporting UK SMEs through new and enhanced products including the General Export Facility, which was launched in 2020. Whilst rises in future impairments and potential losses are possible under a weak economic outlook, long-dated risks are deemed more resilient and could limit UKEF's losses to some extent. Distinct to this, foreign currency risk and volatility directly impact UKEF's total exposure. A significant portion of guarantees and loans are underwritten in US Dollar and Euro. UKEF does not hedge its currency exchange rate risk.

Since the reporting date of March 2022, there have been key changes to UKEF's Buyer Credit (BCG), and Export Development (EDG) Guarantees portfolios. As at March 2023, BCG underwritten during the year decreased by 51% (£1bn) to £0.99bn, whilst EDG increased by 32% (£0.8bn) to £3.3bn. The EDG has continued to gain traction in the market since its launch in 2019 due to continued growth in demand for UKEF's general working capital products, with the EDG accounting for 51% of the direct financial support which UKEF issued in the financial year 2022/23.

Furthermore, in 2022/23, UKEF provided payment risk insurance to cover exports to Ukraine and agreed commitments worth over £50m to support the Government of Ukraine.

³⁴ According to [UKEF's FY 2021/22 Annual Report and Accounts](#) (Page 70), when factoring in commitment business, the Weighted Average Portfolio Rating is B+.

International Development and Foreign Sovereign Guarantees

International development and foreign sovereign guarantees are issued by the Foreign, Commonwealth and Development Office (FCDO).

FCDO has a large portfolio of contingent liabilities, predominantly consisting of financial guarantees and callable capital. The portfolio has grown steadily in recent years, particularly since the commencement of the UK's ongoing support to Ukraine and increased support of multilateral development banks' lending. Due to the very low risk profile of callable capital and the somewhat different nature of liability callable capital constitutes, this section focuses on financial guarantees provided to sovereigns and sovereign-related entities. A summary on the callable capital position can be found at the end of this section.

Performance

At end of March 2022, the FCDO guarantee portfolio stood at £0.9bn. Given FCDO's development focus, guarantees are largely provided to higher risk, lower- and middle-income emerging market countries which tend to be lowly rated. For example, Egypt and Iraq (56% of total exposure as at end of March 2022) are both rated in the 'B' range by Fitch Ratings.

As at March 2022, the expected cost on the portfolio (excluding Gibraltar for which an expected credit loss was not recorded by FCDO) was c.£47m (or around 5% of total exposure). Exposures under the FCDO guarantee portfolio are long dated, typically spanning between 15 – 35 years.

Figure 3.1 – Performance Summary

Country/Entity	Fitch Long-Term Issuer Default Rating	Ratings Outlook	1-year Credit Default Swap (CDS) Probability of Default	CDS Implied Rating (Dec 2022)	Total Exposure (£m)	Expected Cost (£m)
Egypt	B+	Negative	8.4%	B	171	7.2
Iraq	B-	Stable	9.8%	B-	324	31.8
Jordan	BB-	Stable	2.7%	BB-	190	8.0
Gibraltar	-	-	-	-	200 ³⁵	n/a
Total					885	47.0

³⁵ This is a £500m guarantee issued in support of a £500m Revolving Credit Facility. Exposure is based on amount drawn down by Gibraltar on this facility as at March 2022.

Outlook

We anticipate the expected cost on the portfolio will increase given newly announced transactions, in particular the support provided to Ukraine, with a call on the guarantees issued looking increasingly likely due to severe stress to its public and external finances from the war with Russia. Within the portfolio, exposures to Iraq and Egypt also appear to represent the highest risk of materialising given their current rating levels ('B-' and 'B', respectively).

Since the reporting date of March 2022, there have been changes to the FCDO guarantees portfolio. As at March 2023, the portfolio has grown significantly in size

by 61% due to additional support provided by FCDO to a) lending activities of MDBs in support of climate related projects – \$1.6bn guarantee to the African Development Bank (AfDB) and \$1bn guarantee to India to support lending from the World Bank), and b) \$2bn (with further \$3bn support announced in June 2023) to Ukraine (following the invasion of Russia) to support financing from the World Bank.

Other liabilities – callable capital

Callable capital is a financial instrument used by most MDBs. It represents a guarantee that shareholders will provide MDBs with capital to recapitalise the MDB if needed.

Figure 3.J – FCDO Exposure in the form of callable capital exposure

Institution	Total Exposure as at 31 March 2022	Category of Institution and Exposure	Credit Rating ³⁶
Multilateral Development Banks (MDBs)	£14.8bn	International Finance Institutions (IFIs) ³⁷ – £14.8bn ³⁸ GuarantCo Ltd – £130m ³⁹	All IFIs in this category are 'AAA' rated AA-
European Investment Bank (EIB)	£0.2bn	EIB ⁴⁰	AAA

36 These ratings (by major ratings agencies) imply very low Probability of Default.

37 IFIs are financial institutions owned or established by the governments of two or more countries and are subject to international laws. Examples of IFIs include World Bank, European Investment Bank, International Monetary Fund, etc.

38 FCDO's callable capital in the form of investments in IFIs which include African Development Bank (AfDB), World Bank etc.

39 *GuarantCo Ltd is an IFI that encourages infrastructure development in low-income countries through the provision of credit guarantees. In FCDO's 2021/22 annual report and accounts, this figure is not disclosed as part of the callable capital under remote contingent liabilities, but as 'potential obligations' figure for contingent liabilities.*

40 *FCDO's callable capital is in respect of the UK's share of EU member states' collective guarantees of the European Investment Bank's (EIB) lending under the Lomé Convention and the parallel Council decisions on the Association of Overseas Countries and Territories (AOCT).*

MDBs are well capitalised and are structured to ensure that a possible call on callable capital represents a remote risk to shareholders. Due to the low-risk nature of the MDB model, callable capital stock of these IFIs has never been used since its inception in 1944. Furthermore, prior to a call on the guarantee, the MDBs and EIB must first exhaust their own capital resources meaning that any call is unlikely. The UK's capital commitment to the EIB remains on a legacy basis after its departure from the EU.

Housing Guarantee Portfolio

The government's housing-related guarantee portfolio stood at £5.6bn as at March 2022, comprising the Mortgage Guarantee Schemes (MGS), Affordable Homes Guarantee Schemes (AHGS 2013 and AHGS 2020) and Private Rented Sector Guarantee Scheme (PRSGS). Risks to the housing sector could increase amid economic slowdown, rising interest rates, high inflation, and the prospect of rising unemployment.

Mortgage Guarantee Schemes (MGS)

The MGS are managed by HM Treasury and are designed to increase the availability of high Loan-to-Value (LTV) lending to creditworthy customers. Under the MGS, the government guarantees a portion of the lender's first losses (net of recoveries) on residential mortgage loans eligible for the schemes.

There are two Mortgage Guarantee Schemes: the 2013 MGS (no longer open to new applicants), and the 2021 MGS which is due to close in December 2023. The exposures under the 2013 and 2021

schemes as at March 2022 were £139m and £459m respectively.

Performance

Income received means the schemes continue to pose minimal exposure risk for government, with claim volumes remaining low across both schemes as at March 2022.

Outlook

The 2013 scheme is in wind down and will be completely closed in June 2024, with no further claims possible beyond this date. As a result, the government exposure under this scheme should soon represent de minimis levels.

The 2021 scheme remains open to new applicants. Though most borrowers under the 2021 MGS are likely to be tied into a fixed rate mortgage – helping to slow the transmission of higher interest rates – we expect that a significant share of borrowers will need to re-mortgage over coming months, putting pressure on affordability and increasing the risk of default in the event of a change of circumstance such as a loss of employment. Unemployment has been the most important determinant of mortgage arrears in past crises, and we view this as the biggest source of risk to this scheme. With unemployment expected to increase to 4.4% by 2024 (end of 2022: 3.7%)⁴¹, this should mean that mortgage arrears remain below the peak of the global financial crisis (where unemployment peaked at 8.4%). In addition, stringent affordability testing, pre-existing forbearance rules, and flexibilities available through the recently published Mortgage Charter further help to mitigate exposure risks under the schemes.

41 www.obr.uk/efo/economic-and-fiscal-outlook-march-2023

Lastly, we believe that negative equity is unlikely if house price falls are below 10%.⁴²

AHGS 2013, AHGS 2020 and PRSGS

The 2013 and 2020 Affordable Housing Guarantee Schemes (AHGS) were set up by the (now) Department for Levelling Up, Housing and Communities (DLUHC) to provide loans at affordable rates to Registered Providers (RP) for the development of new-build affordable housing through debt raised in the capital markets and guaranteed by the government. The 2013 scheme was closed to new applicants in March 2016, whilst the 2020 scheme remains open to new applicants. The combined portfolio size currently sits at £3.5bn.

The Private Rented Sector Guarantee Scheme (PRSGS), a £3.5bn scheme (currently at £1.5bn portfolio size), was launched in 2014 to incentivise investment in the Private Rented Sector (PRS) by institutional investors and ultimately to stimulate the building of new, purpose built and professionally managed PRS homes across the UK.

Performance of AHGS 2013, AHGS 2020 and PRSGS

The resilience of the 2013 and 2020 Affordable Housing Guarantee Schemes are linked to the operating environment, financial viability, and resilience of the RPs in the respective portfolios, as well as features/mechanisms of the scheme aimed at reducing the risk of the need to call on the government guarantee (e.g. liquidity reserve fund, interest cover ratio, minimum asset cover and valuation, and periodic desktop

and full valuations of housing assets charged to the lender).

Loans in the PRSGS portfolio continue to perform, with no reported arrears or defaults; a reflection of a strong rental market and stringent underwriting of lending under the scheme (including low LTVs and a focus on experienced providers). Current vacancy rates across the portfolio are very low – in line with the broader UK rental market – indicating strong asset quality and robust demand for these types of rental properties.

Outlook for AHGS 2013, AHGS 2020 and PRSGS

We expect RPs, typically investment grade (i.e. BBB- or above)⁴³, to remain resilient in the face of current economic headwinds, partly reflecting the inflation-linked nature of their revenue streams, the countercyclical nature of affordable housing and expectations that any rise in unemployment is likely to be modest, meaning that increases in arrears and bad debts should be contained. Nevertheless, the combined impact of lower revenues (resulting from the rent-cap regime of 7% for Financial Year 2023/24) and growing cost pressures (notably from increased spending requirements to improve the quality, energy performance/efficiency, net zero carbon emissions, and safety of existing housing stocks), will put pressure on margins.

In the private rental market, though the pace of recent rent rises is expected to slow down due to pressures on tenant affordability (resulting from high inflation and increased cost of living), rental growth

42 Based on analysis undertaken on the MGS by CLCC in March 2023

43 AAA to BBB- (or equivalent as assessed by the respective ratings agencies) implies obligors with relatively low Probability of Default.

is likely to remain persistent for 2023, partly reflecting a robust demand for rental properties.

Interest rate risk across all three schemes is reasonably low and well managed through a matching of the interest rate characteristics of the loans and bonds. Due to the fixed rate nature of the interests (until maturity) on these loans, a rise in interest rates is not expected to have a direct impact on the existing loan portfolio (for loans drawn prior to the interest rate increases).

It is expected that default rates and losses to the government's housing guarantee portfolio should be contained as unemployment is expected to rise modestly in 2023 and 2024, remaining comfortably below previous downturns, whilst a conservative approach to underwriting lending under the schemes should support portfolio resilience.

ENABLE Schemes

The ENABLE Guarantee programme is a scheme administered by the British Business Bank (BBB) aimed at incentivising participating banks (mostly challenger banks) and other non-bank financial institutions to increase lending to SMEs. The scheme was announced in 2013 and launched in 2014, with a maximum government exposure of £2bn. Participating institutions are incentivised by government-backed guarantees covering a portion of their net credit losses on a portfolio of loans to SMEs, with the guarantee coverage received in exchange for a fee (which complies with the Commercial Market Operator or Market Economy Operator principle and is agreed on a case-by-case basis). The government assumes a fixed percentage of 'second loss' risk on an SME

loan portfolio which is shared with delivery partners and only covers credit losses if they exceed a certain 'first loss' threshold (which is agreed on a case-by-case basis with the participating institution). As at March 2022, guarantees covering a loan portfolio of up to £1.1bn were active. Government's liability across these portfolios was £0.2bn, increasing to a maximum liability of £0.7bn once all loans are drawn down.

The ENABLE Build programme was launched in May 2019, with a maximum government exposure of £1bn. The scheme is administered by BBB and is aimed at incentivising participating banks to increase the availability of development finance to UK SME housebuilders. The programme operates in a similar way to ENABLE Guarantees but focuses on supporting portfolios of development finance. As at March 2022, guarantees covering a portfolio of up to £0.5bn were active. Government's maximum liability across these portfolios was £0.3bn.

Performance

BBB has yet to record any losses against the ENABLE schemes.

Outlook

Rising interest rates and greater corporate insolvencies due to a combination of inflation levels and slowing economic growth could put pressure on losses across these schemes. Due to the greater protections in place, this is unlikely to result in a call on the guarantees.

Chapter 4: Off-budget Liabilities

Summary

- This chapter examines the government's portfolio of off-budget liabilities for the first time using new data provided by departments. This enables the government to understand its overall portfolio of risk.
- Total expected cost is £23 billion at March 2023, less than 5% of the corresponding amount for on-budget liabilities at March 2022. Government responsibilities represent 65% of this amount, while 26% arises from government as insurer and the remaining 9% from government as guarantor.
- Risk management should focus on the largest items. Of the 933 items identified, 3% result in 86% of expected cost identified.
- There is no one specific sector of the economy that government is over-exposed to regarding its off-budget liabilities. The most significant triggers for off-budget liabilities were identified as successful legal claims (reflecting the large number of legal cases in the portfolio), a major economic or financial downturn and widespread damage to property.
- This analysis provides a step change in government's understanding of portfolio risk. Of the 933 off-budget liabilities identified, 50% are considered unquantified under accounting standards, representing £10.4bn of expected cost per our analysis. This new data source provides the opportunity for further analysis and development to better inform risk mitigation and management.
- The CLCC will continue to publish annual reports on the government's contingent liability stock and generate insights, which will be gained by tracking changes in the portfolio over time.

Figure 4.A – Expected cost of off-budget liabilities at end March 2023, mid-point estimate

Type	On-budget	Off-budget		Total	
	£bn	£bn	%	£bn	%
Government responsibilities	465	15	65%	480	93%
Government as insurer	8	6	26%	14	3%
Government as guarantor	18	2	9%	20	4%
Total	491	23	100%	514	100%

Introduction

This chapter analyses off-budget liabilities which are recognised as contingent liabilities and remote contingent liabilities under accounting standards and disclosed with limited financial information within accounts. A consequence of this accounting treatment is that such items might not be *explicitly* included in government spending forecasts, with the risk that any crystallisations need to be met from savings elsewhere in departmental budgets, or through increases in taxes or debt or broader decreases in spending.

This chapter reports on data provided by departments, which was obtained with the analytical support of the CLCC, and aims to provide a sense of scale of the risk held by government across the portfolio. This represents a step-change in how government analyses and manages its liabilities and is more aligned to standard practice in insurance companies or banks, which use account and policy data and present financial estimates on a number of bases.

In this chapter we first briefly explain the data sources and measure of cost used, greater detail can be found at the end of this chapter and in the annexes. We then summarise our analysis of the portfolio, before focusing on its concentration of risk, past crystallisations, the use of charging, and the terms of off-budget liabilities. This enables us to present much richer analysis of the off-budget liability portfolio and draw comparisons to the portfolio of on-budget liabilities towards the end of this chapter.

Note on data sources and measures of cost

We have worked with 17 departments to collect detailed information on off-budget liabilities, including broad range estimates of future costs. This data corresponds in scope to items expected to be disclosed as contingent liabilities or remote contingent liabilities in the departments' 2022/23 financial statements. This data does not meet the quality thresholds under accounting standards and is not sufficient for analysing or reporting on individual items. But the aggregated information enables government to better understand the scale of its financial exposure to contingent liabilities and the key constituents of this portfolio.

The principal measure used in this analysis is estimated accrued future cost (expected cost), which was explained in **chapter 1**. This figure is a gross cost as it has not been adjusted to net-off any income. Recognising the uncertainties and difficulties in providing cost estimates for this purpose, departments were asked to provide range estimates for each item. Therefore, **wherever we have provided a single point estimate for estimated accrued future cost in this chapter, we have used the mid-point of the range estimate**. The upper and lower bands of these estimates are also presented as range bars in charts, highlighting the uncertainty in these estimates.

Departments also provided an estimate of reasonable worst-case exposure, which while insightful for individual items, provides an inflated view of risk when aggregated at the portfolio level, hence our focus on expected cost.

Portfolio summary

In this chapter we have aggregated information on 933⁴⁴ off-budget liabilities⁴⁵. The expected cost of these liabilities is between £8.9bn and £37.7bn with a mid-point estimate of £23.3bn (less than 5% of the total expected cost for on-budget liabilities). For comparison, the sum of these items' reasonable worst-case exposure is £572.9bn, which results in an inflated view of risk at the portfolio level.

Figure 4.A provides a breakdown of expected costs by category as used earlier in this report. Most costs fall into the government responsibilities (£14.5bn) and government as insurer (£5.8bn) categories.

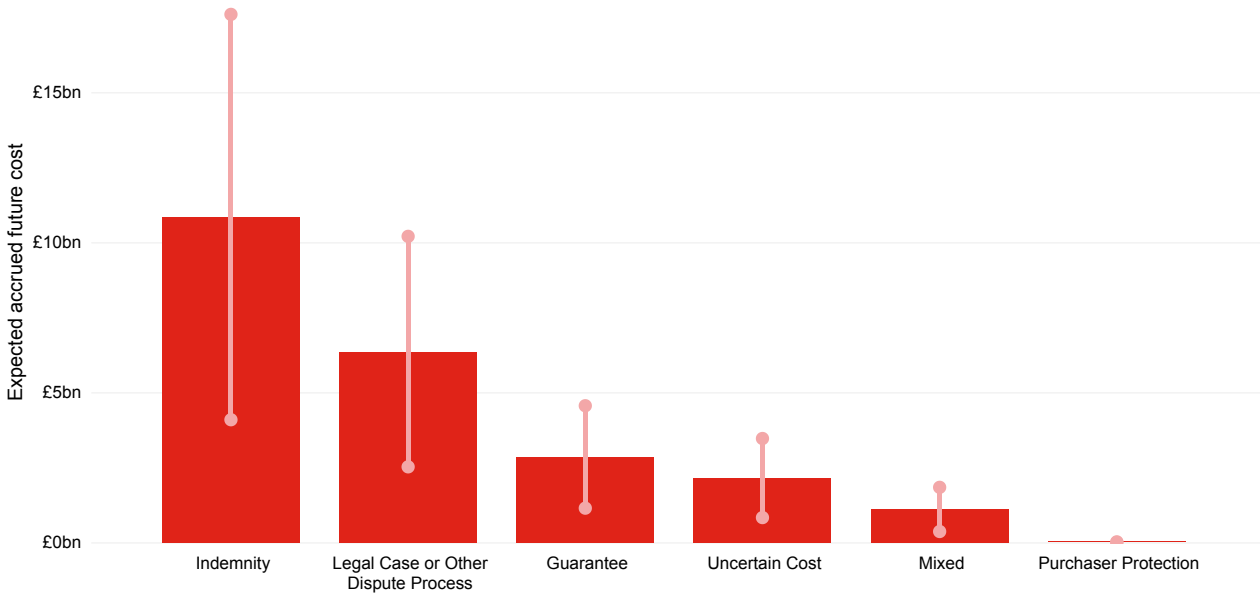
The amounts shown in **figure 4.A** represent all outstanding future costs in respect of past activity or commitments. Such costs will be spread over multiple future years and therefore do not represent expected annual spending amounts. Nonetheless, off-budget liabilities can result in expenditure being incurred as highlighted by the fact that 21% of the 933 off-budget liabilities have experienced some crystallisation. Much of the expenditure that could be incurred from off-budget liabilities is likely to be excluded from explicit spending forecasts. For this reason, off-budget liabilities can impact fiscal outcomes if they crystallise. To address this, we will continue collating data on off-budget liabilities so that changes in the portfolio can be monitored to support government's spending and risk planning.

Off-budget liabilities have been categorised in line with the types of financial products, tools and commitments listed in Annex B. The breakdown is shown in **figure 4.B** below. Indemnities (£10.8bn), legal cases (£6.4bn) and guarantees (£2.9bn) comprise the largest categories by expected cost (with mid-point estimates shown by the bars and the upper and lower ranges shown by the lines). Legal cases and uncertain costs are mostly classified as government responsibilities in the high-level classification shown in the table above. The classification of indemnities and guarantees depends on the precise type and beneficiary.

44 Some contingent liabilities in the portfolio are multiple similar types of liabilities aggregated together into a single entry. This is usually done where there are many small legal claims. This is explained in further detail in Annex E.

45 We initially received 966 contingent liabilities across departments, but this was reduced to 933 during our data validation process. This is explained in further detail in Annex E.

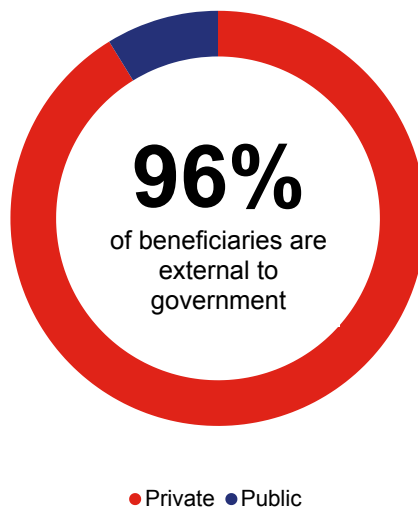
Figure 4.B – Expected cost of off-budget liabilities by financial product and tool



For each off-budget liability, departments were also asked to identify the category of beneficiary. This is the entity that will directly receive government funds if the contingent liability crystallises (for example, the entity indemnified, the entity providing the loan that is guaranteed, or the entity that is in opposition to government in a legal case). Almost all expected cost (96%) relates to beneficiaries that are external to government.

The difference between this result and the high-level classification in **figure 4.A** above is that a cost identified as a government responsibility (for example, costs arising from a legal claim brought against a government body in relation to normal government activities) often involves an external beneficiary. The categorisation between government responsibility, government as guarantor and government as insurer, relates more to the nature of the commitment and the risks inherent in the commitment.

Figure 4.C – Breakdown of expected cost by type of beneficiary: public or private sector



Concentration of risk

A small number of off-budget liabilities represent most of the estimated accrued future cost, as shown in **figure 4.D** below. Through this we note that:

- 12 items (out of 933) each have an expected cost greater than £500m and comprise 64% of the total expected cost;
- 29 items (out of 933) each have an expected cost greater than £100m and comprise 86% of the total expected cost; and

- 617 items have an expected cost less than £1m and, together, contribute around 1% of the total expected cost.

These findings highlight that government could maximise benefits for the taxpayer in the most efficient manner by concentrating its efforts on risk management across its largest liabilities. Furthermore, **figure 4.D** below highlights diminishing returns linked to the level of off-budget expected cost being scrutinised relative to the number of items subject to review as de minimis thresholds are lowered. Therefore, based on this analysis, we will work with departments and concentrate management efforts on off-budget liabilities with an expected cost greater than £100m or £500m.

Figure 4.D – Percentage of the total expected cost by expected cost range groupings

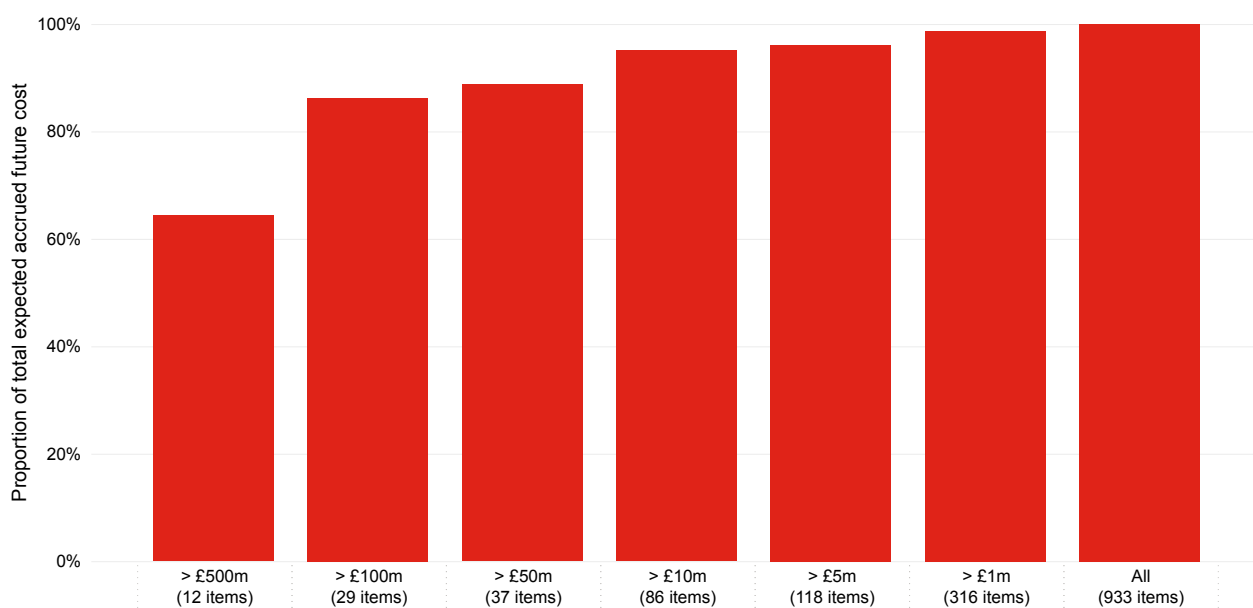
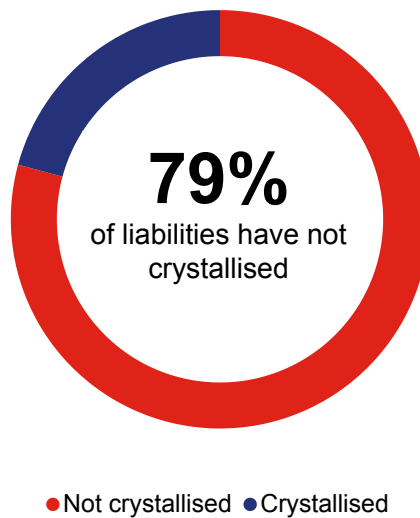


Figure 4.E – Percentage of crystallised liabilities



Past crystallisations

Across the 933 off-budget liabilities, 194 (21%) have resulted in some form of cost to government. To date this has resulted in £23.5bn of expenditure.

Information on past crystallisations is complicated by differences in the term and nature of different items. The information we have gathered relates to total past expenditure relating to off-budget liabilities and therefore amounts are likely to be weighted towards longer-standing items. Furthermore, expenditure is heavily weighted towards a small number of items.

Nevertheless, this data provides a valuable resource when considering and approving new off-budget liabilities. Data on the history of crystallisations, which can be filtered by type of liability and other features, will improve government’s understanding of the likelihood and possible scale of future cost for new items. We will develop benchmarking analysis based on the data the CLCC continues to collect and share this across departments with the aim of improving the quantification of risk.

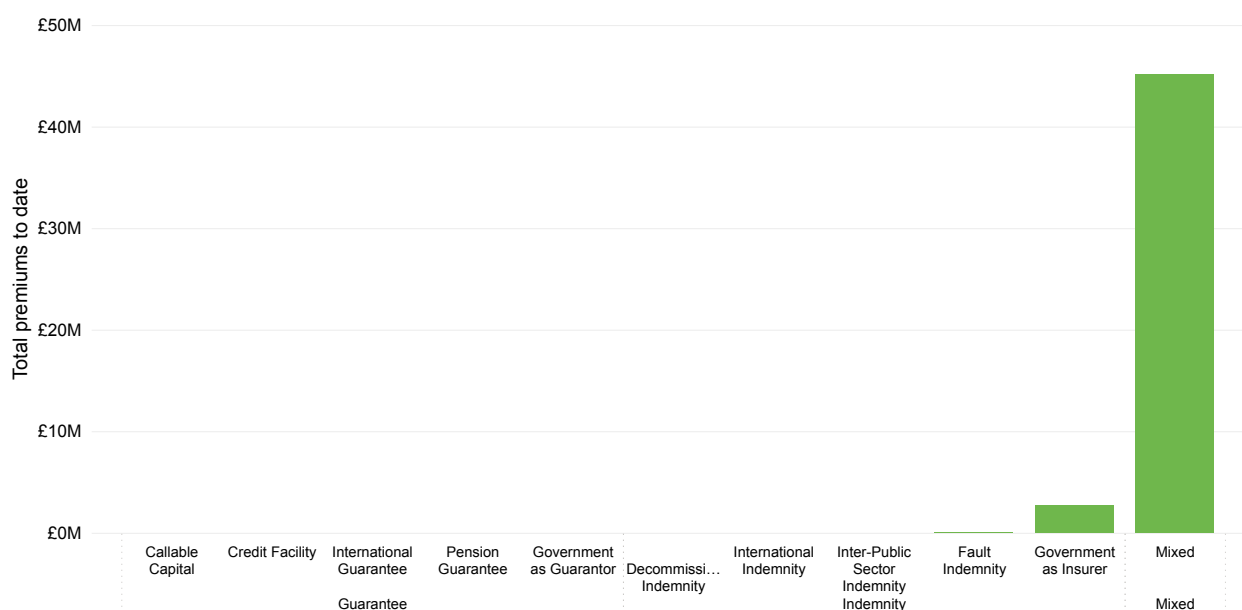
Charging premiums

We have analysed the extent to which government has charged premiums in respect of risk transferred through off-budget liabilities. Managing Public Money requires a risk-based fee to be charged where possible and appropriate when risk is transferred from the private to the public sector.

Looking across all the items identified, premiums are not charged in most cases. By considering the counterparty and type of liability government has entered, we find that charging would also not be appropriate in most cases.

Figure 4.F below shows premiums collected to date for liabilities that have been transferred from outside the public sector. This demonstrates that premiums are not generally collected for items such as callable capital, pension scheme guarantees, and international indemnities and guarantees.

Figure 4.F – Premiums collected to date for liabilities held outside the public sector



Economic sectors and triggers

To better understand the composition of risk held by government through off-budget liabilities, we have examined the economic sector that beneficiaries of liabilities belong to and those they are exposed to. These sectors have been identified in line with the ONS's *Standard Industrial Classifications (SIC)*⁴⁶.

Explanation: Choosing sectors

The **sector of a beneficiary** and **sector generating a risk** can differ. For example, a government guarantee or indemnity could support a commercial lender to encourage them to provide financing to SMEs. In this example, the economic sector of the beneficiary would fall under financial and insurance activities because the beneficiary is the bank, not the SME.

For this analysis, we have focused on the economic sector of risk; the economic sector which most influences the probability and/or size of any future crystallisations of the risk. **Figure 4.G** below shows the spread of economic sectors of risk identified by departments across the portfolio of off-budget liabilities, weighted by expected cost.

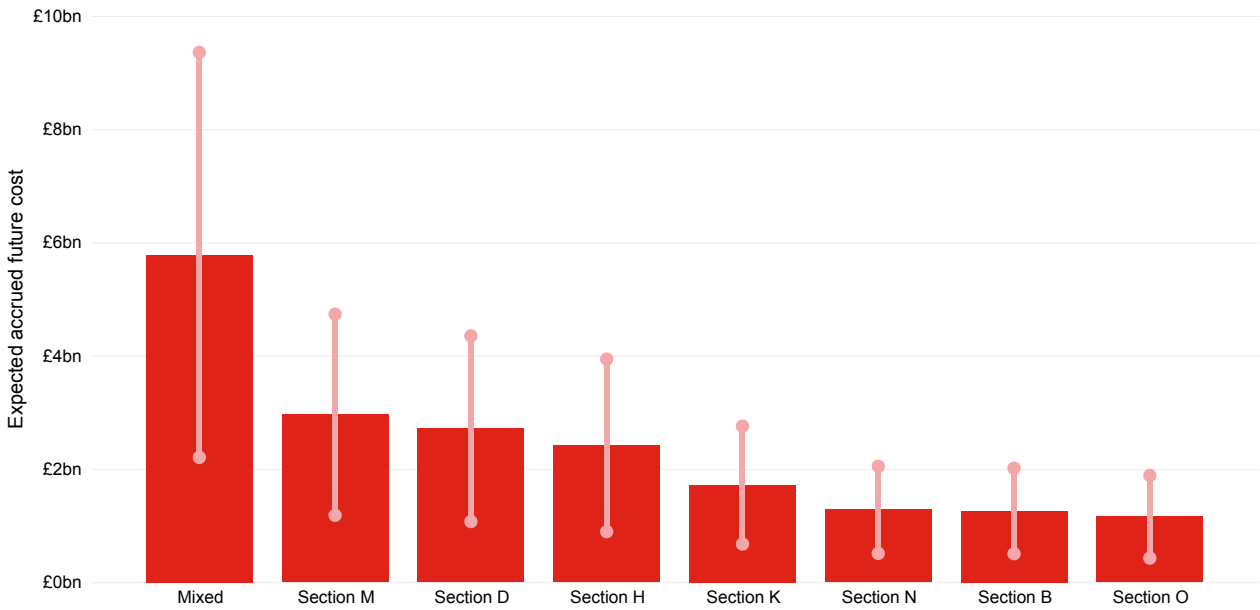
Through this we note that £5.8bn of expected cost from off-budget liabilities is linked to a mix of sectors. In parallel the remaining expected cost is relatively evenly distributed across seven different sectors of the economy. This indicates that government's portfolio of off-budget liabilities is diversified and there is no one specific sector of the economy that government is over-exposed to.

46 www.ons.gov.uk/methodology/classificationsandstandards/ukstandardindustrialclassificationofeconomicactivities/uksic2007

This is an area of analysis that we will continue to track over time. With this we will be able to analyse changes in the composition of government’s exposure to different sectors through off-budget liabilities. This will help inform decision making around risk appetite as it will act as

an early-warning system for any potential concentrations of risk towards a particular sector of the economy. Further, this analysis can help illustrate how the allocation of government support across different sectors changes over time.

Figure 4.G – Expected accrued future cost by economic sector of risk (sectors smaller than £1bn not shown)



- Section M: Professional, scientific and technical activities.*
- Section D: Electricity, gas, steam and air conditioning supply.*
- Section H: Transportation and storage.*
- Section K: Financial and insurance services.*
- Section N: Administrative and support service activities.*
- Section B: Mining and quarrying.*
- Section O: Public administration and defence; compulsory social security.*

Triggers

In addition to examining the source of risks, we have analysed information on the specific events that could ‘trigger’ a liability to materialise and result in a payment made by government.

Definition: Cross Sector Trigger

The event which could most influence the probability or size of any future crystallisations of the risk.

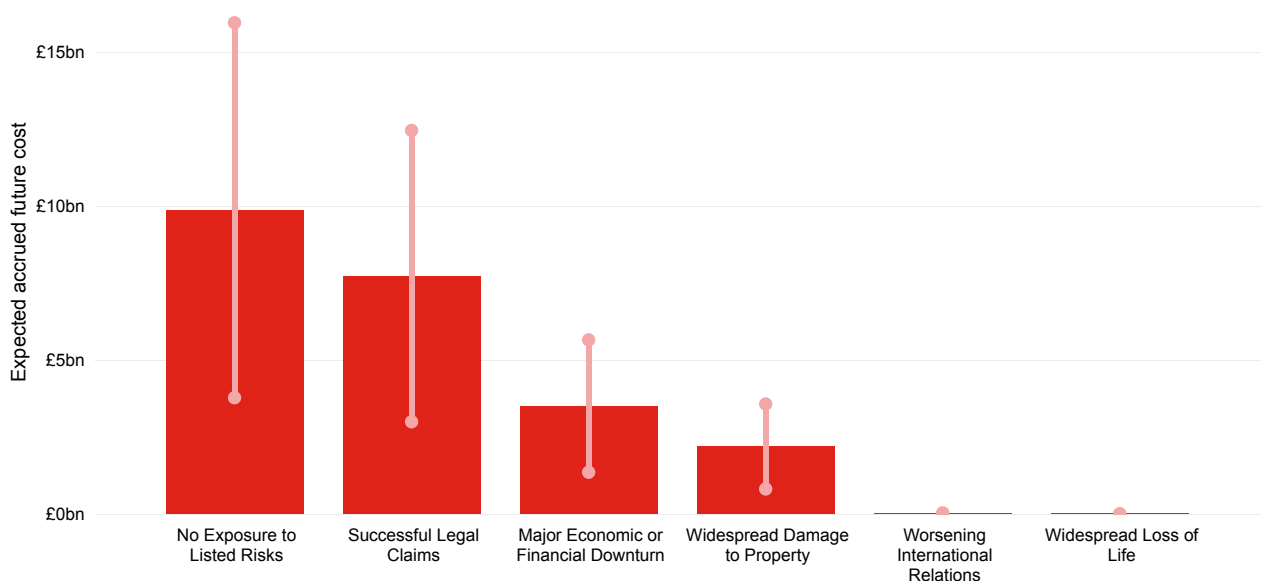
Due to the multi-faceted nature of contingent liabilities and the range of sectors they are exposed to, in most cases it is not possible to identify a single, specific event that would result in a crystallisation. To help address this we will continue to work with departments to improve the quality of data captured in relation to triggers.

The highest single trigger identified across off-budget liabilities is successful legal

claims. This reflects the large number of legal cases in the portfolio. The two other significant triggers highlighted by departments are a major economic or financial downturn and widespread damage to property. Due to the varied nature of the risks identified, insurance solutions may not be a viable option to mitigate against these risks. For this reason, further work is needed to identify the actions required to minimise the risks and the cost of this relative to the expected cost of the risks.

This information on potential triggers of risk provides a valuable insight into the exposure arising from off-budget liabilities. Building on this work, we will conduct further analysis and deep-dives examining concentrations and correlations of risk across groups of liabilities (i.e. on-budget and off-budget liabilities). This work will be focused on government’s major liabilities and how risks they are exposed to can be best identified and managed.

Figure 4.H – Expected cost by cross sector trigger



Term of off-budget liabilities

Off-budget liabilities represent commitments to future expenditure, depending on experience, sometimes for a number of years or even decades.

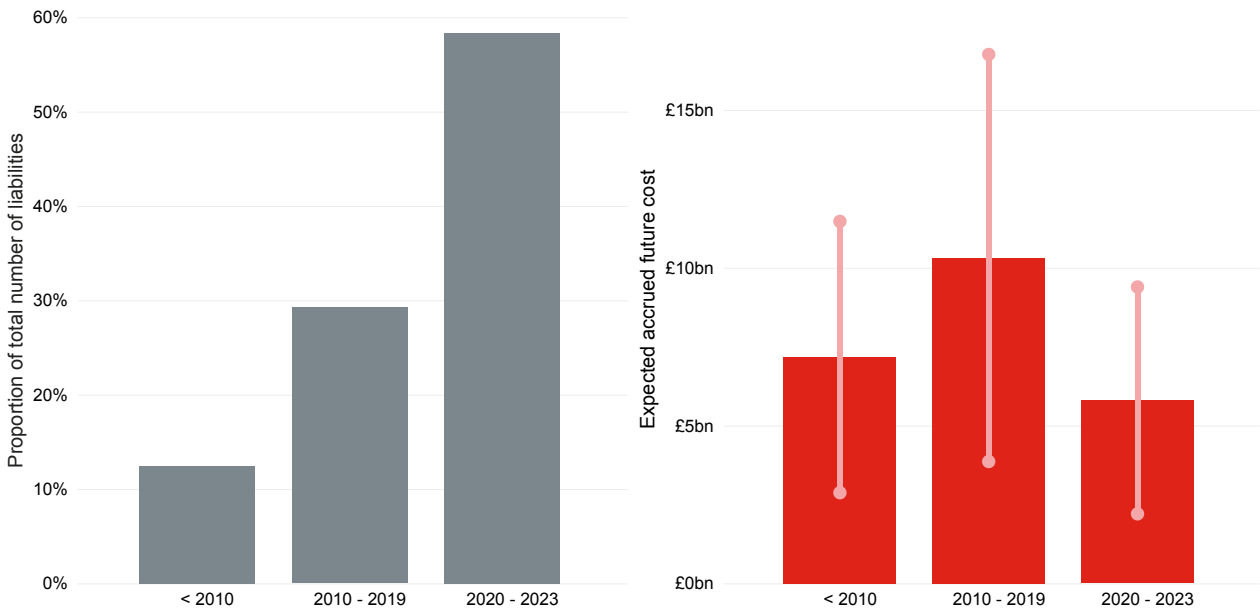
Start dates

The **figure 4.I** below shows that nearly 60% of off-budget liabilities were entered into on or after 2020 and that over 10% of items originated prior to 2010. This illustrates the extent to which obligations can endure over several years.

Examining this based on expected cost suggests that while government has entered

into many new off-budget liabilities since 2020, the average expected cost is less for those liabilities than for older items. Because this is the first time that such analysis has been carried out, it is not possible to say whether this reflects these specific time periods (in particular, the nature of contingent liabilities put in place during the COVID-19 pandemic) or whether this is an enduring feature of contingent liabilities (that older remaining items tend to have higher average expected costs). To discern this, we will continue to track this analysis and examine variations over time as a way of monitoring changes in the risk profile.

Figure 4.I – Count of liabilities (left hand side, grey bars), and total expected costs (right hand side, red bars) by start date



End dates

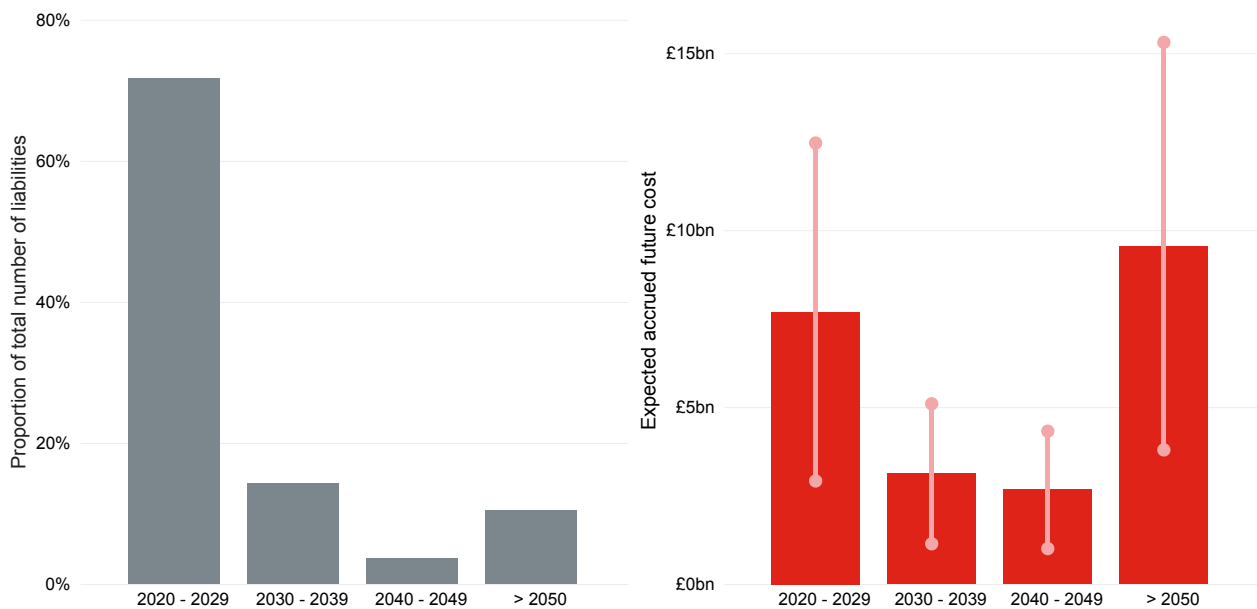
We have also examined end dates for each of the off-budget liabilities identified.

Definition: End Date

An estimate of when government will no longer be exposed to the accrued risk. This includes liabilities without a fixed expiry date, based on an understanding of the risk.

The grey bars in **figure 4.J** below show that 72% of off-budget liabilities are expected to expire by 2030, while 10% of items are expected to endure beyond 2050. Despite the longer-dated liabilities accounting for a small proportion of the total number of liabilities they have higher expected costs, as shown by the red bars.

Figure 4.J – Count of liabilities (left hand side, grey bars) and total expected costs (right hand side, red bars) by end date



Comparison with accounting information

The 2022 CLCC report '*Exploring the UK government's contingent liabilities*' analysed 15 government departments' annual report and accounts. This found that 58% of the 326 contingent liabilities held by government were unquantified. Where the liabilities were quantified, the aggregate **maximum exposure** was £214bn.

This highlighted two key limitations with the information disclosed in financial statements:

1. most liabilities by count are unquantified; and
2. the only available measure of risk is maximum exposure. This provides an inflated view of risk across a portfolio. Furthermore, it does not reflect expected spend and is therefore inconsistent with financial estimates commonly used elsewhere.

While departments' accounting disclosures are prepared in accordance with accounting standards and reflect the statuses of individual items, and while government departments go beyond standard international financial reporting standards through the disclosure of remote contingent liabilities, additional data and analysis is required to understand aggregate risk across the portfolio.

The data we have gathered for this report enables this analysis to be carried out for the first time. This chapter has set out an analysis of aggregate expected accrued future cost from off-budget contingent liabilities, information which has, until now, not been available to government. Of the 933 items we have identified that 50% are classed as unquantifiable under accounting

standards, representing £10.4bn of expected cost per our analysis.

Data notes and limitations

This chapter analyses off-budget liabilities which are, in keeping with accounting standards, disclosed within financial accounts with limited financial information due to uncertainty around quantification or impact. In accounting terminology, they are referred to as contingent liabilities and remote contingent liabilities, respectively. Disclosure requirements for government entities already exceed standard international financial reporting standards due to the requirement to disclose remote contingent liabilities.

Prior to this report, data on these off-budget liabilities was incomplete or inconsistent. We worked closely with departments to calculate, analyse and harmonise information on a large number of individual contingent liabilities and used this to inform our analysis.

The Bank of England's Asset Purchase Facility contingent liability disclosure has been excluded from the analysis as the risk is principally recognised as a financial derivative in the accounts, which is outside the scope of our analysis. Please see Annex D for further information.

Expected cost of off-budget liabilities

Earlier in this chapter we explained that departments were asked to provide range estimates for each item to help produce a mid-point estimated accrued future cost. Further uncertainty relates to the treatment of the highest cost range due to there being no upper bound. The treatment is explained in Annex E and has a material impact on

total amounts due to the concentration of costs in the highest ranges.

As noted in **chapter 1**, the expected cost does not take into account any income received through fees or premiums charged by government (e.g. when taking on risk from the private sector) or any assets (or contingent assets) held against the liabilities.

Reasonable worst-case exposure arising from off-budget liabilities

Departments provided another measure of cost, the reasonable worst-case exposure.

Definition: Reasonable Worst-case Exposure

The reasonable worst-case cost to government over the future lifetime of the liability, representing a pragmatic maximum exposure even where the liability is technically unlimited.

When assessing a single liability, it is necessary to understand the range of outcomes and assess affordability if the liability were to crystallise. The reasonable worst-case exposure measure is helpful in this regard. Aggregating reasonable worst-case exposure amounts across a portfolio presents an inflated view of risk. This is because a worst-case outcome on every item in a large portfolio is such an unlikely outcome as to make the measure meaningless, assuming the portfolio contains some degree of diversification of risk, as we have established above this portfolio does.

Most of the analysis in this chapter does not consider reasonable worst-case exposure for this reason. For further information on sources and limitations of data used in this chapter, see Annex D.

Chapter 5: Improving the Management of On-budget and Off-budget Liabilities

Through this report and the CLCC's work more broadly, we have established a portfolio view of government's on-budget and off-budget liabilities. The objective of this exercise is to improve our understanding of the risks posed by these items and how they can be best managed. This includes steps we can take to improve how we design, implement and manage future schemes individually and as a portfolio.

We set out four aims to guide this work. In this chapter we summarise our findings and next steps linked to these aims.



Identify the scale of contingent liability risk held by government

We have identified £514bn of expected cost across government's portfolio, of which £491bn is on-budget, while the remaining £23bn is off-budget. This latter group consists of 933 individual items and provides a measure of risk where 50% of the items are classed as unquantifiable under accounting standards. We expect government to be able to use this information in a way that informs future decision making. Government can now consider new proposals on their individual merits while also accounting for the impact

new proposals may have on its aggregate risk exposure.

Through further analysis of off-budget and on-budget liabilities we have determined that most of the £514bn of risk held by government is concentrated across a small sub-set of major liabilities. For this reason, we will focus additional analysis and reviews on these liabilities. These reviews will examine how these liabilities are estimated, managed and reported on. In addition, we will undertake further work to specifically identify correlations or interdependencies that exist across these liabilities and between these liabilities and other financial risks faced by government.

In parallel, we will continue to aggregate data on off-budget and on-budget liabilities on an annual basis so that we can track movements across the portfolio more broadly. We will work with government departments to improve the quality of the data captured and drive efficiencies through better standardisation of reporting requirements. Over time we will record and highlight changes across the portfolio, which will support government in gauging its risk appetite and making data-driven decisions on proposals for new schemes and risk planning.

Finally, the on-budget and off-budget liabilities do not represent ‘implicit’ liabilities, which are obligations that potentially arise through public expectation, political pressure, or the role of the state as society understands it. Government retains a higher level of optionality over its response to managing implicit liabilities. CLCC will consider exploring how implicit liabilities could be reflected in the context of government’s overall aggregate portfolio of on-budget and off-budget liabilities in our future work.



Categorise the risk by identifying beneficiaries and concentrations to better understand the overall composition of the portfolio

Our analysis of off-budget liabilities indicates that government’s exposure to economic sectors of the economy is diversified. We also found that most government risk arising from on-budget liabilities derives from government responsibilities (expected cost £465bn). This suggests the overall level of risk held by government is relatively stable, although we highlight that there is limited information on triggers that could result in crystallisations across off-budget liabilities. In addition, we highlighted how assumptions can significantly influence the expected cost and annual expenditure incurred from on-budget government responsibilities.

In response, our work to improve the quality of information captured by government will include a greater focus on data linked to triggers. We will also undertake reviews of government’s major liabilities with the intent

of better understanding the events that could lead to their crystallisation and what, if any, options there are to mitigate this. As part of this, we will work with organisations that hold similar types of risks so that assumptions and analysis are developed in a consistent and standardised manner. These activities will generate efficiencies through better standardisation and active data sharing across departments.



Determine whether government is charging adequately for the risk it takes on

Our findings suggest that where appropriate, government is charging the private sector at adequate levels for the risk it takes on in most cases. This likely reflects the increased scrutiny the *Contingent Liability Approval Framework* and *Managing Public Money* place on charging. CLCC’s next step is to consider other mechanisms of risk sharing across government’s portfolio. For this reason, we will undertake further research to explore how contingent liabilities could be tailored (for example through the use of more complex structuring arrangements) to optimise the way in which government support is provided to the private sector.



Consider how to improve value for money across the portfolio

Through this report we have identified activities that we can undertake to improve

the design and management of on-budget and off-budget liabilities, and therefore, ensure value for money. Primarily, we will aim to do this by using data to generate efficiencies.

We will develop analysis based on the data included within this, and future, reports to help departments to benchmark relevant metrics linked to new proposals against past experience. In addition, we will identify opportunities to build new models that could be used as tools to expedite and improve government's estimating capabilities. Through these tools, government departments will be able to improve how estimates for new proposals are developed.

At the portfolio level we will continue to replay the information we gather across government to decision-makers in a way that allows them to consider the impact of actions on new or existing schemes across government's portfolio. We will aim to develop and share analysis mapping interdependencies and correlations of risk across different segments of government's portfolio. Over time, we will scope how this analysis can be consolidated into a single platform that will take the form of a Central Liability Monitoring Hub.

As shown in **chapter 3**, where government implements business-as-usual guarantee schemes, there is a longer time horizon for thorough structuring and optimised risk-sharing. However, in some circumstances government has needed to deliver both guarantee and insurance schemes at pace, such as during the COVID-19 pandemic (with insurance schemes to support the arts and entertainment industry, or guarantee

schemes to support businesses) or in response to energy price shocks (with the Energy Market Financing scheme)⁴⁷. It is possible that government will need to consider the rapid rollout of large guarantee or insurance schemes in the future in response to economic conditions. In light of this, we will undertake further work to explore how government could best design and implement such schemes at pace, drawing on lessons learnt from previous schemes.

47 The Energy Market Financing Scheme was designed to support eligible energy firms meet extraordinary margin calls caused by market volatility. There were no applications during the availability period and the scheme closed without any utilisation.

Annex A: Definitions

#	Definition	Page(s)
1	Amount at risk the outstanding amount due from an obligor, on a liability (net of all repayments made to date, and value of any security or reserves held against that liability), over a specific period.	44
2	Beneficiary the entity that will directly receive government funds if the contingent liability crystallises, i.e. the entity indemnified, the entity providing the loan that is guaranteed, or the entity that is in opposition to government in a legal case.	15
3	Bounce Back Loan Scheme (BBLs) a scheme introduced to support smaller businesses with a fully guaranteed loan (up to £50k) in the wake of the COVID-19 pandemic.	7
4	Contingent liabilities are defined by the government as fiscal commitments undertaken by the government that are uncertain in terms of timing and quantum and lead to future spending if certain discrete event(s) occur.	2
5	Counterparty the other party (a person(s), entity, or collection of entities) that participates in a contract or financial transaction.	45
6	Credit default swap (CDS) a contract between two parties in which one party (a lender) purchases protection from another party against losses from the default of a third party (a borrower) for a defined period. The CDS pays out upon occurrence of a credit event, which includes bankruptcy, failure to pay, and, in some countries, involuntary restructuring.	48
7	Credit rating an independent assessment of an obligor's (legal entity, government, or government related entity) creditworthiness in general terms or with respect to a particular debt or financial obligation. Credit ratings are issued by credit rating agencies based on issuer default ratings scale ranging from 'AAA' (reflecting the strongest credit quality with the lowest Probability of Default) to 'D' (reflecting the lowest credit quality with the highest Probability of Default).	46
8	Cross sector trigger the event which could most influence the probability or size of any future crystallisations of the risk.	61
9	Crystallisation is the point at which a contingent liability is realised and there is an obligation to pay.	9

#	Definition	Page(s)
10	<p>Discount rate a financial assumption used to determine the present value of future payments. For the purposes of preparing government departments' financial accounts, discount rates are prescribed by HM Treasury, and vary across provisions, financial instruments, and pensions. For provisions, the rates issued by HMT are based on Bank of England yield curves of conventional government bonds (UK Gilts). Please see Annex D for further information.</p> <p><i>Example: A liability of £100m is due in one year's time. We need to determine the amount of money to set aside today, to ensure we have sufficient funds to meet the liability in one year's time. Assuming a single discount rate assumption of 2.0% per year, an amount of £98m would need to be set aside now. If we assume the liability is due in 2 years' time, we would need to set aside an amount of around £96m, allowing the funds to accumulate at 2% per year compounded.</i></p>	8
11	<p>Double default occurs when the obligor/counterparty and guarantor or supplier of credit insurance both fail to meet their financial obligations under a financial transaction or agreement.</p>	45
12	<p>Economic sector of risk the economic sector which most influences the probability and/or size of any future crystallisations of the risk.</p>	59
13	<p>End date an estimate of when government will no longer be exposed to the risk. This includes liabilities without a fixed expiry date, based on an understanding of the risk.</p>	63
14	<p>Estimated accrued future cost the category which reflects the expected cost range over the liability's future lifetime, as at reporting date, without deducting any premiums collected.</p>	6
15	<p>Expected cost/expected credit cost the amount a lender might lose by lending to a counterparty/borrower that may default.</p>	6
16	<p>Fee charging a sub-categorisation of insurer/guarantor of last resort, to denote whether there is a charge being applied to this respective liability.</p>	6
17	<p>Financial guarantee an agreement that guarantees a financial obligation (debt) will be repaid to a lender by a third party (the guarantor) if the counterparty (the borrower) defaults.</p>	26
18	<p>First loss position the amount or portion of a portfolio that will suffer the first economic loss if the underlying assets in the portfolio lose value or are foreclosed upon.</p>	50
19	<p>Government as guarantor refers to instances where the government chooses to offer a guarantee because the private sector is unwilling or unable to cover the risk, and the government wants there to be that option.</p>	6
20	<p>Government as insurer refers to instances where the government offers and indemnity because the private sector is unwilling or unable to cover the risk, and the government wants there to be that option.</p>	6

#	Definition	Page(s)
21	Government responsibilities is a term we have used throughout this report to represent future contingent or uncertain expenditure that the government is legally or contractually committed to incurring because of its past public sector related activities. The commitments arise from activity that the public view as government's responsibility. This includes inter-public sector agreements, legal cases, and historical environmental decommissioning.	6
22	International Financial Reporting Standards (IFRS) a set of accounting rules created to bring consistency and integrity to accounting standards and practices, regardless of the company or the country. The IFRS is issued by the International Accounting Standards Board (IASB).	18
23	Impairment a permanent reduction in the value of an asset	42
24	Off-budget liability refers to a liability that is, in accordance with accounting standards, disclosed in the notes to accounts with limited financial information. In accounting terminology, these are known as contingent liabilities and remote contingent liabilities.	54
25	On-budget liability refers to a liability that is, in accordance with accounting standards, included in financial accounts. In accounting terminology, these are provisions, financial guarantees, or insurance liabilities.	21
26	Probability of default/default probability the likelihood that a counterparty (borrower) will fail to meet its financial obligation on a certain debt.	45
27	Provisions future funds required by an organisation to cover expected future expenses arising from a specified past event, where the expenses have a greater than 50% likelihood of being incurred. In accordance with accounting standards, these are included in financial accounts. <i>For the purposes of this report, provisions made by government departments are largely considered as part of Government responsibilities.</i>	2
28	Reasonable worst-case a loss event considered very unlikely to occur but not improbable. The event should be based on the exposure to government from the liability over its future lifetime as at the reporting date.	18
29	Risk appetite the maximum amount of risk (after controls and other measures have been put in place) that an organisation is willing to take in pursuit of objectives it deems have value.	60
30	Second loss position the amount or portion of a portfolio that will suffer a further economic loss (after the first loss position) if the underlying assets in the portfolio lose value or are foreclosed upon.	52

Annex B: Contingent Liability Categories

In the tables below, the on-budget expected cost is stated as at 31st March 2022, while the off-budget expected cost is stated as at 31 March 2023. Please see Annex C for further details.

Indemnity

Sub-category	Description	On-budget Expected Cost (£bn) (At March 2022)	Off-budget Expected Cost (£bn) (At March 2023)
Procurement indemnity	An indemnity offered to a supplier as part of a procurement contract.	0.2	3.6
Government as insurer	An indemnity offered because the private sector is unwilling to cover the risk, and the government wants there to be that option.	7.9	2.9
Decommissioning indemnity	An indemnity due to obligations to clear a site.	279.0	1.9
International indemnity	An indemnity arising due to agreements with other countries or international organisations.	33.3	1.3
Fault indemnity	An indemnity offered to protect a non-government entity from damage due to government activity.	2.6	1.3
Appointment indemnity	An indemnity against personal liability offered to an individual appointed to a role.	0.0	0.1
Inter-public sector indemnity	An indemnity offered to another government entity within the public sector.	0.8	0.4

Guarantee

Sub-category	Description	On-budget Expected Cost (£bn) (At March 2022)	Off-budget Expected Cost (£bn) (At March 2023)
Callable capital	A potential obligation from holding callable shares in an organisation.	0.0	1.4
Government as guarantor	A guarantee offered because the private sector is unwilling to cover the risk, and the government wants there to be that option.	16.2	< 0.1
International guarantee	A guarantee arising due to agreements with other countries or intranational organisations.	0.2	0.1
Pensions guarantee	An obligation relating to shortfalls in a funded pension scheme.	0.0	1.4
Credit facility	An obligation to provide loans up to a certain amount to an entity.	2.1	< 0.1
Inter-public sector guarantee	A guarantee offered to another government entity within the public sector.	0.0	< 0.1

Legal Case & Other

Sub-category	Description	On-budget expected cost (£bn) (At March 2022)	Off-budget expected Cost (£bn) (At March 2023)
Legal case	When a lawsuit is brought against government.	137.5	6.2
Other dispute process	A process whereby government is making a case to a third party to avoid paying damages.	1.3	0.2
Purchaser protection	An indemnity offered to an organisation purchasing or using a government asset.	0.0	< 0.1
Uncertain cost	A cost to government which is uncertain, such as employment costs or uncertain take up of funds.	10.2	2.1
Unknown/Mixed	There is not enough information to determine a category, or there are multiple categories of liabilities.	< 0.1	1.1

Annex C: Scope

Effective dates

On-budget liability data has largely been captured from departmental annual report and accounts (ARA), up to and including the financial year ending 31 March 2022. At the time of writing this report, some departments had published their 2022/23 ARA but some had not. However, for consistency across departments, we have continued to present the data on 31 March 2022, and noted any material changes to results on 31 March 2023.

The off-budget liability data was acquired by working across departments to develop and aggregate new management information as of 31 March 2023.

The difference in effective dates across the datasets is related to practical issues – the data gathered on off-budget liabilities was aligned to departments’ processes for preparing their 2022/23 accounts. Given the large amount of work required to produce the most recent data a request for departments to simultaneously consider the previous financial year would have caused practical difficulties due to the amount of resource and time required to comply.

While we recognise the potential implications of summarising datasets at different effective dates (e.g. limitations in comparing on- and off budget contingent liabilities), we are still able to provide an indication of the risk and the order of magnitude across government’s portfolio – this is an improvement on the data that has been available to date.

Departments included

For this report, we have collected data from 17 central government departments.

Abbreviation	Department Name
BEIS⁴⁸	Department for Business Energy and Industrial Strategy
CO	Cabinet Office
DCMS⁴⁴	Department for Digital, Culture, Media and Sport
DEFRA	Department for Environment, Food and Rural Affairs
DfE	Department for Education
DfT	Department for Transport
DHSC	Department of Health and Social Care
DIT⁴⁴	Department for International Trade

48 At the time of the data collection exercise, BEIS, DIT, and DCMS still existed as separate departments. As at February 2023, these departments have undergone machinery of government changes and split into four new departments: DESNZ, DSIT, DBT, and DCMS. However, for the purposes of our analysis, we have retained the department names under which the data was received.

Abbreviation	Department Name
DLUHC	Department for Levelling Up, Housing and Communities
DWP	Department for Work and Pensions
FCDO	Foreign, Commonwealth and Development Office
HMRC	His Majesty's Revenue and Customs
HMT	His Majesty's Treasury
HO	Home Office
MoD	Ministry of Defence
MoJ	Ministry of Justice
UKEF	UK Export Finance

Our analysis relies on each department's group accounts providing a consolidated view of the core department, its arm's-length bodies (ALBs), and their subsidiaries within the department's accounting boundary.

Departments excluded

At this stage, we have not considered contingent liabilities held by the public sector beyond our remit, which currently does not include devolved administrations or local authorities. Additionally, ministerial departments with no identified, or material, contingent liabilities are not included within this report.

Annex D: Data Sources and Limitations

The analysis included within this report should be treated as unaudited administrative data and should not be considered as national or official statistics.

On-budget liabilities

Information on financial guarantees, indemnities and provision line items – which collectively represent on-budget liabilities in this report – were sourced from departmental annual report and accounts (ARA) for the 17 departments listed under **Annex C**. Data consistency checks against the consolidated Whole of Government Accounts were also carried out, which at the time of writing ran up until financial year 2020/21. These sources are considered robust and reliable given that the data is aggregated and reported on in line with government's interpretation of the International Financial Reporting Standards (IFRS) accounting standards called Financial Reporting Manual (FRM), and the returns have been through the necessary parliamentary clearance processes.

During the data collection and aggregation process, we identified relevant on-budget liabilities and placed them into categories which were developed by the CLCC (see **Annex B**). Furthermore, through this process, we have excluded a small number of line items. In particular, the Bank of England's (BoE) Asset Purchase Facility (BEAPFF) has been excluded as financial derivatives are outside the scope of our analysis; and the Department for Transport's (DfT) Network Rail inter-public sector guarantee as it is an intra-departmental financial guarantee. Given the materiality of these items, further information has been provided below.

Bank of England's Asset Purchase Facility

The Bank of England's Asset Purchase Facility conducts the BoE's operations for quantitative easing and tightening. HM Treasury's indemnity to the BoE and BEAPFF is represented on HM Treasury's balance sheet as a derivative.

Between 2009 and 2022, the facility's activities generated positive net cash flows for HM Treasury, peaking at a cumulative £124bn at end-September 2022.

Following rises in interest rates in 2022 and 2023, the facility started to make cash losses which are the responsibility of HM Treasury to pay. HM Treasury paid out a total of £5bn between October 2022 and January 2023. The fair value of the derivative liability as at 31 March 2023, as presented in HM Treasury's accounts, is £177.6bn. This amount broadly represents the money that HM Treasury would need to pay out if all of the BEAPFF's assets were sold at fair value and the liabilities commuted. In practice, however, the final amount will depend on the approach taken by the independent Monetary Policy Committee (MPC)

to unwind the assets and the path of future interest rates. This amount therefore does not represent an outstanding or near-term cash transfer requirement on HM Treasury.

Department for Transport's Network Rail guarantee

The Department has given an indemnity to Network Rail's debt holders covering total outstanding debt as at 31 March 2022. The indemnity expires in 2052 and is recognised on the balance sheet as a financial guarantee contract. The indemnity reduces the cost of borrowing for Network Rail.

Explaining movements to the discount rates March 2022 to March 2023

As described in the report, and further in **Annex C**, to ensure consistency across departments we have presented data as at 31 March 2022. Discount rate assumptions have changed materially between 31 March 2022 and 31 March 2023. Further information is provided below to supplement the commentary in the report about this change.

For the purposes of preparing government departments' financial accounts, discount rates⁴⁹ are prescribed by HM Treasury, and vary across provisions, financial instruments, and pensions. For provisions, the rates issued by HM Treasury are based on yield curves of Bank of England conventional bonds (UK Gilts) and can be broadly viewed as representing the cost of borrowing for government.

Since 2021/22, the long-term discount rates used to value provisions have been updated annually. Before this, the long-term rates were updated at each multi-year Spending Review which typically covered periods of 3 to 4 years. The change in the market rates of UK Gilts between review periods resulted in a large increase in the provisions observed between the financial accounts as at March 2021 and March 2022 (the "very long term" discount rate decreased from 1.99% to 0.66%).

Market rates for UK Gilts increased significantly during 2022/23 and will influence the value of provisions presented in the March 2023 accounts (the "very long term" discount rate increased from 0.66% to 3.00%). These increases to the discount rates are anticipated to reduce the value of the provisions.

Off-budget liabilities

The process to capture disclosed contingent liability data represented a large amount of work across government as this data, in many instances, did not previously exist. We were reliant on departments identifying and providing data for off-budget liabilities in line with its definition.

49 Further information on discount rates can be found in Managing Public Money and the Government Financial Reporting Manual.

Data exclusions

We have excluded ‘implicit’ liabilities which, rather than arising explicitly through law or contractual obligations, represent obligations that potentially arise through public expectation, political pressure, or the role of the state as society understands it. These areas may be explored in future reports.

We received data pertaining to a total of 966 contingent liabilities. Through our data validation process (see **Annex E**) this was reduced to 933. The 33 excluded liabilities represent less than 4% of the total portfolio of liabilities by count.

Our data validation process identified liabilities to be excluded from our analysis based on the following criteria:

- Liabilities where no expected accrued future cost was provided
- Liabilities that had expired as at the reporting date of March 2023 and further costs in relation to these are not expected
- Liabilities which have been captured elsewhere in our quantifications in this report where manually cross checked (such as financial guarantees)

Exclusions were made for specific charts in our data visualisation to ensure clarity. If certain liabilities met the validation criteria but lacked necessary information, they were omitted from the chart. It is important to note that these exclusions did not impact the overall conclusions and do not represent a substantial proportion of the overall population.

Data limitations and sensitivity analysis

The purpose of this report is to analyse liability data on an aggregate, portfolio level. This choice was made as the data collected does not meet the quality thresholds under accounting standards and therefore analysis of individual items is not appropriate. The data we gathered used range estimates of expected costs, on the basis that having some (albeit limited and uncertain) information on the scale of risk was better than seeking more precise information that would not be available for some items.

Figure D.1 – Table of expected cost ranges departments could choose from in the data collection

Expected Cost Ranges						
< £1m	£1m to £5m	£5m to £10m	£10m to 50m	£50m to £100m	£100m to £500m	> £500m

Some consistency checks have been carried out on this data and queries discussed with the organisations that supplied it (see **Annex E**). Due to the volume and nature of this data, however, we are not in a position to independently check every data point provided. As this was the first time such data has been collected, it is to be expected that there would be some gaps and limitations in the data provided. We will work with departments to further improve the information collected for subsequent reports.

Use of counts

This report includes counts of liabilities as a measure of quantification. We allowed departments to group liability types that contained many similar, small liabilities, such as legal cases, into single line items to reduce the burden of work. For this reason, the total number of liabilities may be understated, and rates derived from counts may not be comparable between different years.

Despite these limitations grouping benefits accuracy, especially when dealing with small cases well below the threshold of our minimum expected loss category. By grouping these, we can reduce the overestimation of risk caused by having large expected loss ranges.

Reasonable worst-case exposure

Defined in **Annex A**.

Where new data was gathered (including new exposure estimates for items) to feed into this report, we used a broad definition of ‘reasonable worst-case’. This acknowledged the challenges in estimating exposures and the potential burden of overly demanding requests on organisations. Respondents were granted the freedom to determine these values using the definitions outlined in **Annex A**. For this report, the primary goal was to acquire this measure for every contingent liability.

As expected, the data received for this measure varies significantly across different risks. It is evident that for some risks, a measure more closely resembling the maximum exposure was utilised, while for others, more consideration was given to the amount reasonably possible.

This year’s data will serve as a baseline for the CLCC to identify anomalies and assist departments in enhancing data consistency moving forward.

As discussed in the report, while the use of the reasonable worst-case exposure is valuable when considered individually against each item’s estimated accrued future cost, it can create an impression of an inflated level of risk when aggregated across the entire portfolio. The estimated accrued future cost (expected cost) is a more significant measure when assessing the portfolio as a whole, and consequently, more attention has been devoted to it when performing the analysis for this report.

Estimated accrued future cost

Defined in **Annex A**.

Departments were asked to quantify the “Estimated Accrued Future Cost” for all off-budget liabilities. Given that this measure has not previously been collected from departments, we decided to collect this data as ranges, rather than point estimates.

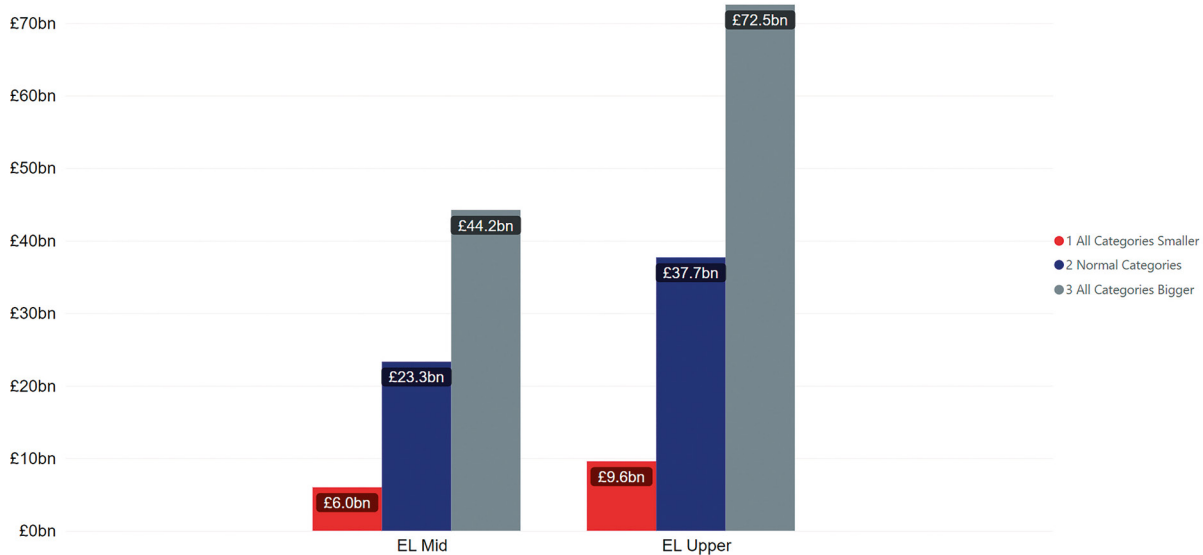
The top range is defined as “> £500m” with no upper limit given. Based on our understanding of the liabilities we assumed an upper end of £2bn. This creates a limitation

that the upper end assumption will need to be re-evaluated each time new data is collected and also creates a risk that changes to this number could have a large effect on the values for off-budget risk.

Given this, and that the range in each category is large, we wanted to understand in a worst-case if every liability shifted either up or down a band what effect it would have on cost.

We added a limit that said a liability would not move up if it would make the expected loss larger than the reasonable worst-case (as it shouldn't be the case that these numbers are similar). We also created a new band on top from £2bn to £10bn to test the effect of our top end assumption being too low.

Figure D.2 – Effect on Expect Cost values of changing off-budget liability
Expected Cost range estimate



The upper end of these sensitivities represents the absolute worst-case of all liabilities being under-estimated and our assumptions for the maximum size also being too small. This roughly leads to a doubling of the risk. However, in the context of the on-budget risk it is still relatively much smaller.

The size of the bands could also be changed, i.e. making them smaller with more bands to increase accuracy. Doing this would have even less impact than the sensitivity above as the data is most sensitive to changes to the large items, but smaller bands would at most incrementally increase the size of these liabilities (and likely some would get smaller).

Start/End Date

There are many different reasonable definitions that could refer to the start or end of a liability. For example, the date the liability first existed, the date it was recorded on departmental minutes, or the date it was recorded on parliamentary minutes. This, combined with the diverse nature of contingent liabilities, means that even within departments there are likely to be liabilities with different date definitions.

Trying to capture all of these for all liabilities would be very onerous and add little value. We have captured the best date organisations had (and if none is available a best estimate). This does mean that individual liabilities will use different date definitions, but in aggregate this will be smoothed out, and we took the approach that some information is better than none.

Where there were gaps (usually in the case of perpetual liabilities with no end date) we have used assumptions. We did not perform any sensitivity analysis on these as we have not included any second order analysis of dates such as cashflows that would be affected meaningfully by changes to the assumptions.

Annex E: Checks Performed

On-budget liabilities

We collected balance sheet line items on financial guarantees, provisions, and insurance solutions from the annual report and accounts of the 17 departments listed under Annex C. Additionally, historic, and re-stated values were also included as part of the data collection process, with both being cross-checked against the Whole of Government Accounts.

Once aggregated, the data went through two stages of quality assurance to ensure completeness and factual accuracy. The first of these assurances involved an internal check carried out by the CLCC's actuaries and credit specialists. Using a pre-determined script, the team ensured that the following three broad checking classes were satisfied:

1. external data checks;
2. calculation checks; and
3. contingent liability classification checks.

Check classes 1 and 2 ensured that the data had been correctly lifted from departmental accounts in accordance with internal data collection rules, and the second ensured that – where presented in the report – all totals, percentages and ratios were correct. The final check utilised a mixture of internal data classification rules supported by analytical judgement.

The second stage of quality assurance was performed by the Government Actuary's Department (GAD). The primary purpose of its review was to ensure that a) no obvious flaws were detected in the data collection approach; and b) individual line items were correctly categorised as a provision, financial guarantee, or insurance contract. Furthermore, whilst GAD did not conduct a line-by-line check on the source data items, they were able to verify that all subsequent calculations were carried out correctly. Overall, GAD confirmed that the analysis and results presented in the report were materially correct.

Off-budget liabilities

Received data

The data we gathered on off-budget liabilities went through several stages of checking to ensure completeness and quality.

The first stage of checking was built into the template we used to aggregate this information, in the form of input validation, to ensure cells had the correct data type in them, as well as error checks on each column and row to alert the user to any issues. Upon receiving each completed template, we would manually check and correct (if possible) highlighted errors and agree the changes with organisations.

The second stage used a Python script to combine data gathered into one combined data set. The script then cleansed and added to the data with the following steps:

1. Set datatypes of columns and coerce values into the correct type
2. Check categorical columns match the validated lists of allowed entries
3. Input assumptions for missing dates
4. Add columns for:
 - a. Numerical values of range inputs
 - b. Binary flags summarising categories
 - c. Second order information such as the duration between start and end date
 - d. Sensitivity checks

After this the script checked for the following issues:

1. Duplicated unique IDs
2. Missing values
3. Incorrect data types
4. Categories that don't match the allowed input values
5. Start dates after end dates
6. Premium charged but not agreed

It also flagged the following as part of sense checks:

1. Dates unusually far in the past or future
2. Very large reasonable worst-case and/or expected losses
3. Very high probabilities
4. Expected loss larger than reasonable worst-case multiplied by probability
5. A premium or a crystallisation was provided
6. No cross-sector trigger was selected

These errors and sense checks were then output as individual Excel files, which formed part of an iterative process of improvements and new data being submitted and re-checked.

Quality assurance of and internal review

A quality assurance review of our Python script was performed by GAD. The primary scope of this quality assurance was to review the code, looking for obvious errors and anywhere that best practice was not being followed, and to test that the code functioned as expected by running test cases through it. The review was not a line-by-line check that the code works.

An internal review was performed by members of the CLCC on the classification of the items into government responsibility, government as guarantor and government as insurer groupings.

