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the department for Enterprise

The Hon. Tim Sainsbury, MP
Minister for Trade

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Our ref WO1
Your ref
Date 27 December 1990

Dear Chief Secretary

IRAQ: PREMIUM REFUNDS

1. I am replying to Norman Lamont's letter dated 19 November. (I enclose a copy of earlier correspondence for your convenience).

2. Whilst I of course sympathise with the Treasury's general point that we must take account of ECGD's potential losses on Iraq in setting our refund policy, I am afraid that Norman's proposal does not properly address the reality of the difficulties which we face. Perhaps I can best explain this by dealing with the specific points in his letter:

2.1 The Treasury argue that ECGD's losses will arise because it continued to insure exports into Iraq well beyond the time it was prudent to do so. This seems to me what the Americans call 20:20 hindsight. ECGD's potential losses have arisen because of the Gulf crisis, not for balance of payments reasons. These events were unpredictable, and questions of prudence are not relevant to risks driven by force majeure reasons.

2.2 ECGD's administration costs are not, as Norman implied, recouped by a uniform percentage levy on the premium rates. Such an approach would lead to an over-reliance upon high risk business (which generates high premium) to cover administration costs. Accordingly, the administrative margin in the Iraqi premium rate is considerably less, in percentage terms, than the average of 20% for all business. Reflecting this in the proportion of refund would not, therefore, lead as you fear to ECGD under-recovering its overall administration costs in a manner consistent with financial objectives.

2.3 In most of these cases, the only insurance contract which exists is between ECGD and Midland in respect of the non-payment of the loan by Iraq. This is because of the way in which these particular lines of credit with Iraq were structured. The lines of credit cover many small contracts, in respect of which the Exporter has not entered into any sort of written agreement with ECGD. Technically the obligation to pay premium was upon the Bank, but they fulfilled that obligation by asking the Exporters to pay directly to ECGD. Having now examined the many cases coming forward for premium refunds, we suspect that the entire nature of the arrangements may not have been explained to the Exporters, and they may not have been aware that the credit could be suspended or terminated in certain circumstances. The situation is complicated because there are two classes of Exporters: those who have a contract with ECGD (where premium is being paid by deferred instalments), and those who do not. In any event there would appear to be a risk of application for judicial review on the grounds that suppliers had been encouraged to have reasonable expectations of payment which, in the event, have been denied.

ECGD is now conducting an urgent review of its lines of credit arrangements, but the results will not help us to deal with Iraq. There is an obvious risk that judicial review could stray into wider areas and it is, in my view, in the Government's interest that we should try to minimise the possibility of Judicial Review by being more flexible on refunds of premium.

2.4 Therefore, contrary to the argument set out in paragraph 6 of Norman's letter, I believe that if we were to follow that course, there is a significant risk of a Court action against ECGD to recover premium which could have consequences for our wider stance of refusing to pay compensation for losses arising as the result of sanctions.

As I mentioned above, some exporters affected are paying ECGD premium by deferred instalment (this is standard policy so that the exporter's contract cash flow can be matched to his premium obligations to ECGD). This would mean some exporters who had drawn less finance than the premium payable to ECGD would, in fact, still have obligations in respect of premium instalments which are not yet due. It is possible that some exporters will refuse to pay the instalments, in which case ECGD need to take legal action to recover the sums concerned, and this again could expose our general policy on Sanctions to Court scrutiny.

3. However, in order to reflect the Treasury's concerns, I am prepared to adjust my original proposals. In determining the amount of refunds to be paid to exporters who have drawn less finance than premium paid, we would also take into account interest which had accrued under the ECGD-guaranteed loan. Thus we would subtract from the premium payable the amount of drawing plus the accrued interest, and refund to the exporter 85% of the difference. Thus we would completely cover any potential loss before making any refund.

4. ECGD estimate that the cost of these revised proposals would be about £9.0m. This compares to the cost of my original proposal of £9.7m, and to the cost of the Treasury's of £4.5m.

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5. In the light of my arguments, I hope that you will feel able to accept this proposal. As I said in my earlier letter, this will not stem the flow of representations and complaints, which is continuing, but it can still be defended as a reasonable balance between the exporter and taxpayer.

6. As you know, the Export and Investment Guarantees Bill has its Second Reading on 15 January. It would be most helpful if you would agree before then.

7. I am copying this letter to the Prime Minister, Foreign Minister, Defence Secretary and to Sir Robin Butler.

Yours Sincerely

James Styles

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(approved by the Minister for Trade and signed in his absence)

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