Managing Risk in the Overseas Territories: Annexes A to D

Annex A: National Audit Office Methodology

1. We designed the study to address three main issues.

   - Is HMG working in conjunction with Territory governments, to effectively manage and mitigate specific categories of risk to the UK from the Overseas Territories?
   - Does HMG have appropriate cross-cutting arrangements in place for identifying, prioritising and responding to risks from the Territories?
   - Are suitable and sufficient resources available to, and deployed by, HMG to manage the risks to the UK from the Overseas Territories?

2. Our preliminary research involved:

   - Meetings with key staff responsible for the Overseas Territories in the Foreign and Commonwealth Office ("The Department") and the Department for International Development (DFID), including specialist advisers for Economics, Disaster Management, Financial Services, and Law Enforcement;
   - Review of the Department and DFID records on risk in the Territories; including economic reviews and Governors' reports to London;
   - Collation and analysis of data, including International Monetary Fund reports on financial regulation, and on public accountability through audit and Public Accounts Committees in the Overseas Territories;
   - Meetings with officials of the principal other UK departments and agencies involved, including HM Treasury, the Department for Transport, Air Systems Safety International, the Maritime and Coastguard Agency, HM Inland Revenue and Customs; and
   - Short intensive visits to Anguilla and the adjacent British Virgin Islands, gaining a deeper understanding of the issues faced by Territory Governors,

and the stance of Territorial governments towards a wide range of risk exposures.

3. From this preparatory work we derived a conceptual model (below) for the efficient overall allocation of risk, concluding that notwithstanding strict constitutional interpretation of responsibilities, most risks are inherently shared and would benefit from a co-operative UK/Territory approach to their management.

Methodology

4. The full study methodology expanded on the more traditional, interview-based approach adopted by our predecessors in 1997-8, through the following additional elements:

   i. Reference to the most analogous statement of Best Practice in Risk Management, the Risk Management Toolkit produced in 2003 by ALARM, the Association of Local Authority Risk Managers, as a Framework for analysis.

   ii. A short survey of the Governors, and of the local governments in each Territory, asking them to identify and grade for severity the risks that they face, and the adequacy of the risk mitigations in place. This provided us (and the Department) with the most systematic basis yet for deployment of our resources; as well as new information on different perceptions regarding risk between the Department on one hand and Territorial governments on the other. We designed the survey with reference to the ALARM approach to risk classification, piloting it in one Territory (the British Virgin Islands).

   iii. Targeted visits to Territories, focusing on the areas of greatest risk to the UK. Structured interviews with the major stakeholders relevant to the selected risk areas and review of key documentation, such as Territory disaster plans.

   iv. Benchmarking for risk areas where systematic data is now available. This included summarisation of the results of International Monetary Fund inspections of offshore financial centres, instituted since 2003. We halted initial work to benchmark public sector administration in at least one Territory against the new PEFA standards recently developed by the World

Bank having established that both the Department and DFID had used non-compatible assessment criteria.[1]

v. Use of specialist advisers for the disaster management and financial services areas, to supplement our in-house expertise.

vi. Discussions with Ministries responsible for Overseas Territories in other EU countries, to identify their practices in managing risk. This work focused on the Netherlands, recognising the fundamental differences between the UK's relationship with its Overseas Territories on one hand and the more integrated relationship between France and its Territories on the other.

Advisers

5. The role of our specialist advisers was to help draw up our fieldwork programmes and to examine key documents, such as disaster plans, against best practice:

- Tony Moore is Associate Director of The Resilience Centre at the Cranfield University outstation at MOD Shrivenham. He is Chairman of the Institute of Civil Defence and Disaster Studies and the co-editor of Tolley's Handbook of Disaster and Emergency Management.
- Richard Pratt was Director General of the Jersey Financial Services Commission from 1999 until early 2004, and was previously a civil servant within HM Treasury working on financial services regulation. Currently in private practice, he is on the Implementation Committee of the International Organisation of Securities Commissions (IOSCO) - responsible for developing and implementing international regulatory standards. He also participated in the review by the international Financial Action Task Force of its recommendations to defeat money laundering.
- We consulted ALARM prior to the development of our risk assessment Framework.

[1] PEFA (Public Expenditure and Financial Accountability) is a multi-agency partnership programme sponsored by the World Bank, the IMF, the European Commission, UK DFID and other international aid donors. Its role is to provide a common framework and benchmark for assessment of public expenditure management in recipient countries, through a standardised range of high level indicators under some 28 categories. Inspections have been under way since 2004.

Conceptual model: Recognising the optimal allocation of risks between the UK and Overseas Territories

Generally accepted rules for the efficient allocation of risks between parties usually incorporate two main principles:

- Which party is best placed to influence the occurrence of the risk;
- Which party would incur the consequences of the risk should it transpire, and is therefore best incentivised to prepare and mitigate.

In practice, determination is complicated due to “moral hazard”, the possibility that the party best placed to prepare will not in fact do so, expecting that the other party would meet any future costs of rectification or restoration.

Clearly the balance will vary between Territories according to their circumstances. But the overall conclusion from the analysis below is that in populated Territories, most risks are inherently shared between the local community and the UK.

Material Risks in the table below are derived from the output of the NAO survey of Governors and governments, as most significant in terms of probability and impact.

Risks	Constitutional responsibility	Rationale for risk allocation in terms of managing occurrence and consequences	Implications for optimal allocation of responsibility
External Security / Defence	UK – Governor	UK is best placed to manage the risk. Only the UK has sufficient specialist resource to mount a defence, and would face most costs if the risks transpired.	UK - Governor
Internal Security	UK - Governor	In practice, the great majority of resources for maintaining internal security are usually provided by Territory authorities. And the consequences of crime and insecurity, short of major civic disorder requiring UK intervention, would be incurred mainly by and within the Territories themselves. Some specialist expertise and technical support is likely to be best provided externally, from the UK.	RISKS SHARED. Approaches to increase local participation in law enforcement issues are most likely to be effective.
Natural Disaster	Local governments	In practice, the great majority of resources for maintaining internal security are usually provided by Territory authorities. And the consequences of natural disaster, short of extreme and lasting economic damage, would be borne by Territories themselves. The point at which disaster would demand major UK assistance would vary according to each Territory’s economic strength or range of capabilities.	Local government, except where local finances and contingencies are weak compared to the scale of the threat.
Transport Safety and Security	UK - Governor	The UK influences Territories’ exposure to risk by entering into international commitments and standards on their behalf. It could also incur reputational and financial damage if local failures led to disasters. Some specialist expertise and technical support is likely to be best provided	RISKS SHARED

		externally, from the UK. Conversely, the Territories incur some of the costs of regulation, and face many of the commercial and wider economic risks, for example if their airports, ports and craft were to be blacklisted.	
Offshore Financial Services	Government in four Territories. Governor in three Territories	The UK influences Territories' exposure to risk by entering into international commitments and standards on their behalf. It could also incur reputational and financial damage if failures led to financial abuse or scandal. Conversely, the Territories, or firms within them, incur most of the costs of regulation, and face many of the commercial and economic risks if regulation fails, for example if their financial services were to be internationally blacklisted.	RISKS SHARED. A co-operative approach is likely to be most effective for both sides.
Deficit in Public Finances	The Local government leads in most Territories with settled populations. UK elsewhere	Except in DFID-assisted Montserrat, St Helena and Pitcairn, local governments raise and deploy their own financial resources. Consequences of poor financial management would initially be met locally, through budget cuts and other corrective measures. But in the case of more severe financial difficulties leading to widespread hardship and unrest there would be practical and moral pressures on the UK to provide at least temporary assistance.	Local government lead, but with UK oversight to prevent overstretch and to constrain short-termist decision making.

Annex B: The UK's main levers and powers in Territories

Table 1: Levers available to the UK in influencing Territory actions		
Lever	**Applies to…**	**Workings and Example**
Legislative levers		
Statute	All Territories	Westminster can pass primary legislation for all the Overseas Territories
Constitutional Orders in Council	All Territories	The Constitutions of Gibraltar and British Indian Ocean Territories are contained in Orders made under the Royal Prerogative. The Constitutions of all other Territories are contained in Orders made under a statutory power, e.g. the British Virgin Islands Constitution was made under the West Indies Act 1962.
Order in Council under Statute	All Territories	Orders can be made for all Overseas Territories where a UK statute provides for this, e.g. United Nations Act 1946, under which UN sanctions Orders are made for all Territories. There is power under various statutes to legislate for all Territories by Order in Council on specific topics e.g. relating to shipping, aviation, outer space, extradition, and various other matters. These powers are used quite regularly, especially to implement UN sanctions, and are almost invariably used with the agreement of the Territories concerned.
Reserved Prerogative Orders in Council	All Territories except Bermuda	The reserved prerogative power of Her Majesty to legislate by Order in Council for the peace, order and good government of the Territory. This power is usually used with the agreement of the Territories, but was used in 2000, to decriminalise homosexuality for those of 18 years and above in the Caribbean Territories when local governments refused to legislate.
Disallowance of legislation	All Territories, except Gibraltar, where it was abolished in 2007. The power is limited to Bills relating to government stock in Bermuda.	The Secretary of State can disallow legislation that has been assented to by a Governor. This power is almost never used, but the threat of it can be a useful lever in persuading a Territory to amend objectionable legislation.
Power of assent	All Territories	In all Territories, the Governor must assent to local bills before they can become law. The Governor must reserve a bill "for the signification of Her Majesty's pleasure" in defined circumstances, e.g. on instructions from

		the Secretary of State, or to ensure compliance with international obligations (the precise circumstances vary as between Territories). In limited cases, the Governor may refuse to assent.
Governor's legislative power	All Territories apart from Bermuda and Montserrat	In Territories with no permanent, settled population (including the St Helena dependencies of Ascension Island and Tristan da Cunha, and Pitcairn Island), the Governor (or equivalent) has sole legislative power. In all other Territories except Bermuda and Montserrat, the Governor has power to push through a bill (or an amendment) in defined circumstances. This is only occasionally used as it could be viewed as undermining local democratic process. It was last used in 2004 in the Cayman Islands to force an amendment to a telecommunications bill regarding the interception of phone conversations.
Executive levers		
Governors constitutional responsibilities	Territory-specific	Governor's special responsibilities typically involve external affairs, defence, internal security and the public service. There are varying arrangements, some informal, to consult Territory governments in exercising these responsibilities, and in some cases responsibilities are delegated to local Ministers.
Governor's position as Chair of the Executive Council	All Territories except Bermuda and Gibraltar	As chairman, Governors can influence the agenda of the Executive Council/Cabinet and can seek to influence the outcome of discussions while respecting the will of the democratically elected government. The Governor can, and exceptionally does, override ExCo on the Secretary of State's instructions, or in matters affecting the Governor's special responsibilities. The Governor threatened to use this power in the Turks and Caicos Islands to block the sale of areas of Crown Land.
Territory-specific levers		
Disallowance of specific spend	Territories in receipt of DFID	DFID disallowed the St. Helena fuel subsidy to force the St. Helena Government to allow a price rise in fuel.
Freezing capital spending	Territories in receipt DFID aid	
Preventing borrowing	Territories able to Borrow	The borrowing guidelines are agreed between the Department and the Territory government
Territory-specific Governor powers	All Territories	Governors have traditionally controlled appointments to senior public, judicial and constitutional offices. In all Territories except

		Bermuda and Gibraltar, Governors have the final say in public service appointments. The current constitutional review process is resulting in public service commissions (PSC) with a more executive status, some members of which are nominated by local politicians. But safeguards through Governors' powers to nominate members and to disregard the advice of the PSC are also included.

Annex C: Foreign and Commonwealth Office and DFID funding in Territories

<u>Overseas Territories Programme Fund</u>

Administering Department: The Foreign and Commonwealth Office

Total amount: Approximately £4million per year (allocation of £3.537million in 2006/07)

Eligibility: All Territories

Funding criteria: Bids should come under one or more of the Programme's six strategic objectives, set by the Department's Overseas Territories team in London;

- Promote good governance, and political and economic transparency in the Overseas Territories;
- Improve justice systems and security of the Overseas Territories;
- Reduce the vulnerability of Territories to natural and non-natural disasters;
- Encourage more diversified economic development;
- Support the Territories in meeting international obligations; and
- Support environmental management and the implementation of Environmental Charters in the Overseas Territories

Projects that focus on sustainability and capacity building will be prioritised.

Assessment Process: Bids for the Fund are submitted for initial assessment by the relevant Governors' Office, and are then reviewed by the Overseas Territories Assessment Panel. The Programme Board provide policy guidance on the overall Strategy for the Fund, and have oversight of Programme allocations. There were two bidding rounds in 2006 during which a total of 118 project forms were submitted to the Assessment Panel[2]. For the 2007/08 year, the Board will contain a DFID representative for the first time

Monitoring: Governor's Offices should submit a quarterly progress report showing financial returns, the key objectives that have been achieved in the previous quarter, and any significant developments or changes to the project. However,

[2] This does not equate to 118 projects as some projects recommended for rejection were resubmitted during the second bidding round.

Territory returns do not yet provide a sufficient level of detail. Capacity constraints in Territory Governor's Offices limit their ability to carry out project monitoring.

Territory	**OTPF funding for 2006/07** **£000**	**Main area/s of expenditure**
Anguilla	182	Law and order
Ascension Island	97	Law and order
Bermuda	0	
British Indian Ocean Territory	140	Humanitarian
British Virgin Islands	37	Economic diversification
Cayman Islands	38	International obligations
Falkland Islands	58	Economic diversification
Gibraltar	0	
Montserrat	119	Disaster management
Pitcairn Island	44	Governor's delegated budget
South Georgia and the Sandwich Islands	24	Governor's delegated budget
St Helena	29	Law and order
Tristan da Cuhna	104	Economic diversification
Turks and Caicos Islands	141	Law and order and governance
Cross-Territory	1,111	Law and Order
Ad hoc projects	1,373	BIOT administration, Antarctic Treaty

Overseas Territories Environment Fund

Administering Department: Jointly funded and administered by the FCO and DFID

Total amount: Approximately £500k per Department (total of £1,000,000)

Eligibility: All Territories

Funding criteria: The aim of the Fund is "enhanced quality of life and livelihood opportunities for the inhabitants of all UK Overseas Territories through the sustainable use (or protection, where necessary) of environmental and natural resources, whilst securing global environmental benefits within the scope of the core principles of the relevant multilateral environmental agreements."

Bids are considered against the project's ability to;

- meet the Territory's obligations under multilateral Environment Agreements extended to it, and preparing for possible future extensions;
- build environmental management capacity; and
- raise awareness of environmental issues; encourage local decision making; and supporting environmental education in the Territory.

Assessment Process: Bids are assessed by a panel which consists of independent specialists, government officials, experts from academic, educational and scientific institutions, and representatives of Non-Governmental Organisations through the UK Overseas Territories Consultative Forum.

Monitoring: Project implementers must report quarterly to the Fund administrators, but there is ambiguity about what other project outputs are required. A, mainly positive, review of the Fund found that there was no clarity on the requirement to submit a full final report after project completion[3].

UK Development Programme

Administering Department: DFID

Total amount: Variable. The expenditure for 2005/06 was £30million.

Eligibility: Currently Montserrat, St Helena and Pitcairn receive development assistance. The Turks and Caicos Islands and Anguilla received small amounts in 2005/06 for development projects/technical assistance only.

Funding criteria: The aim of development assistance is to meet the "reasonable assistance needs" of the UK Territories. There are three types of funding available;

- *Budgetary aid* - the shortfall of Government expenditure versus revenue. The amount needed for budgetary aid determines the amount available for the other funding.

[3] A REVIEW OF THE OVERSEAS TERRITORIES ENVIRONMENT PROGRAMME (OTEP), International Institute for Environment and Development (IIED), February 2006

- *Development Budget* - This aims to invest to improve, whereas budgetary aid aims to keep the Territory solvent. Projects include large infrastructure developments or replacements.
- *Technical co-operation* - a supply of technical expertise and knowledge, usually people on short term contracts. Some are locally appointed by the government and DFID may supplement their salary to assist in recruiting suitably qualified personnel from the international market.

Assessment Process: Non-competitive. DFID determines need based on an annual Aid Planning Mission, which scrutinises the Territories finances and forecasting models to determine the best way to allocate the Development Programme funds across the Territories which require it.

Monitoring: Monitoring is carried out through regular contact between DFID and the Territories, and the formal annual Planning Mission, which scrutinises Territory performance as well as determining future allocations. DFID also carry out ad hoc reviews on specific projects, for example Montserrat's Housing Project, and periodic fiduciary risk assessments.

<u>**Other Regional Programmes**</u>

Administering Department: DFID

Total amount: The total, cross-Territory expenditure for 2005/06 was £1.2million.

Aims and criteria: Depends on the specific programme. Most are aimed at assisting Territories to meet their international obligations under various Treaties and Conventions, which the UK has signed them up for. There are eight Regional Programmes which have recently received DFID funding;

- Disaster Management
- Child Protection
- HIV/AIDs prevention and awareness
- Law Reform
- Government Accounting Reform
- Climate Change
- Human Rights
- Environmental Regulations and Conventions

Annex D: Summary of findings from National Audit Office survey of risk in the Overseas Territories.

Territory Governors and governments of populated Territories were invited to complete a National Audit Office risk survey to identify risks which had the potential to require UK Government assistance, either to respond to the risk should it occur, or to help mitigate against it. The survey requested that respondents give each identified risk a score out of four for the likelihood of it occurring, and the severity of impact should it occur (where a score of 1 indicated a very low likelihood or impact, and 4 indicated a high likelihood or severe impact).

All Territory Governors and four Territory governments returned a completed survey.

	Severity = impact x likelihood (1 very low impact and likelihood and 16 is very severe impact and very likely to occur)				**No. Territories citing this risk**	**Percentage of Territories requiring UK assistance if risk materialised**	**Examples of assistance required**
Risk	**Initial Risk**		**Residual Risk**				
	Total	**Average**	**Total**	**Average**			
Political							
Terrorism or assassination	**19**	**3.8**	**18**	**3.6**	5	100%	Security assistance (emergency and longer term), help dealing with the media
Corruption or political instability	**13**	**6.5**	**6**	**3.0**	2	50%	Deployment of security forces, longer term economic assistance
Lack of public sector capacity	**18**	**9.0**	**10**	**5.0**	2	100%	Contractors and UK personnel (at higher cost)
Military Action	**12**	**6.0**	**6.5**	**3.3**	2	100%	Deployment of UK Military
Poor governance	**10**	**5.0**	**6.5**	**3.3**	2	100%	Technical assistance
Breakdown of government	**9**	**9.0**	**3**	**3.0**	1	100%	UK Government intervention
Discrimination of Expatriates	**6**	**6.0**	**3**	**3.0**	1	0	N/a
Environmental							
Tsunami/earthquake	**26.5**	**3.8**	**25.5**	**3.6**	7	71% (100% if	Emergency humanitarian

						severe)	assistance, financial aid, Consular assistance. Could also require long term aid for reconstruction
Hurricane (cat 4 or 5)	47	7.8	40.5	6.8	6	67% (85% if severe)	Emergency humanitarian assistance, financial aid, Consular assistance. Could also require long term aid for reconstruction
Flu/other pandemic	29	4.8	21	3.5	6	83%	Food and other assistance, medical advice
Volcanic activity	23	5.8	17	4.3	4	100%	Evacuation, Emergency humanitarian assistance, financial aid
Damage to natural/marine environ	18	4.5	11.5	2.9	4	25% (100% if severe)	Technical assistance if severe or not meeting regulations
Oil spillage/pollution	15	3.8	10	2.5	4	25%	Technical advice on dealing with problem
Decline of fisheries	14	7.0	10	5.0	2	100%	Return to budgetary support
Nuclear incident	8	4.0	6	3.0	2	100%	Specialist clean-up assistance, not available in Territory
Rockfall	13	6.5	5	2.5	2	0	
Social							
Public Disorder	17	2.8	14	2.3	6	67% (93% if prolonged)	UK Police Forces and maritime assets
Population decline	42	8.4	17.5	3.5	5	40%	More personnel needed from UK to restore capacity
Prison riot/escape	25	5.0	17	3.4	5	40% (60% if severe)	UK training and deployment of experienced UK personnel
Drugs and Crime	26	6.5	17	4.3	4	75%	UK security support and expertise
Illegal/mass immigration	25	6.3	22	5.5	4	75%	Security forces, UK and international humanitarian assistance
Social tension	12	6.0	10	5.0	2	0	

Technological							
Loss of power/communications	33	4.1	19.5	2.4	8	63%	Support/expertise to restore power (possibly financial)
Maritime incident	37	5.3	27	3.9	7	71%	Emergency medical support, consular assistance, help with US communication
Aviation incident	33	4.7	22.5	3.2	7	100%	Air crash investigators, medical aid if serious incident
Loss of transport links	9	4.5	7	3.5	2	100%	Finances to restore links e.g. subsidy
Legal							
Inadequate Financial services regulation/money laundering	35	7.0	15	3.0	5	100%	Technical/legal support, contribute to payment of any fines
Adverse Legal Judgements	28	7.0	16	4.0	4	100%	Financial assistance to pay any costs due
Inadequate aviation/maritime regulation	19	4.8	12	3.0	4	75%	Technical/legal support, ASSI involvement, provision of trained personnel, contribute to payment of any fines
Failure to comply with International Regulations	17	5.7	6	2.0	3	67%	Technical/legal support
Law suits against Territory	15	5.0	11.5	3.8	3	100%	Legal fees plus damages costs
Major company collapse	9	3.0	3	1.0	3	0	
Economic							
Wider Economic downturn	39	7.8	28	5.6	5	40%	If severe, return to UK budgetary support
Tourism downturn	29	5.8	21	4.2	5	60%	If severe, return to UK budgetary support
Financial Services Competition/downturn	23	5.8	13	3.3	4	75%	If severe, return to UK budgetary support

Failure/delay of major project	**30**	**10.0**	**18**	**6.0**	3	67%	Substantial investment in new ship/transport
Government financial mismanagement	**19**	**6.3**	**7**	**2.3**	3	0	
Reserves exhausted	**19**	**6.3**	**7**	**2.3**	3	33%	If severe, return to UK budgetary support
Aid dependency	**22**	**11.0**	**19**	**9.5**	2	100%	Ongoing UK aid, development assistance to break cycle