PES (2003) 16 Annex 4

REQUIRED RATE OF RETURN (RRR) OF TRADING FUNDS

The statutory duty of the Trading Fund is "to manage funded operations so…revenue of the Fund… is not less than sufficient taking one year with another to meet outgoings which are properly chargeable to revenue account." Funds are also required to achieve such further financial objective as has been determined by the responsible Minister (with Treasury concurrence) and set out in a Treasury Minute laid before the Commons.

2. Financial targets for trading funds are largely a consequence of decisions on charging policy. RRR should reflect the activities undertaken by each Fund which may be statutory, commercial, "inter-departmental" or a mix of those. The RRR is therefore determined individually for each Fund. About half have an existing RRR of 6 per cent (because their activities are predominately statutory or inter-departmental) with others having targets ranging from 6.5 to 10 per cent.

3. Some thoughts on the procedure for departments to follow in the review of RRR are that they:

- start the review of their Trading Funds' RRR from the presumption that all Trading Funds should achieve a RRR of at least 3.5 per cent, with higher returns being expected depending on the proportion of their business which is, or may be, subject to competition. However, returns of less than 3.5 per cent may be set for policy reasons such as the correction of over–recoveries on statutory services in previous years. Such arrangements are expected to be very much in the minority;

- require their Trading Funds to identify the proportion of their business which should be priced at a cost of capital/ROCE of 3.5 per cent; and the proportion where there is or may be competition and which should earn a higher rate of return (and which rate).

- assume Funds may (as now) have a RRR which is measured over each accounting year separately, or "taking one year with another", or over a specified period of years, whichever appears appropriate given the nature of the Fund's services. (But where an existing RRR is measured over a specified period of years including 2003-04 or later years and is higher than the RRR indicated by the review, the existing RRR will need to be terminated early so as to avoid over-charging.)

- note the precise date from which the new RRR is effective may need to take account of factors such as the timing of the introduction of fees and charges on the new basis, and the time needed to agree and lay a Treasury Minute setting out the new RRR.

4. A further paper will need to be issued dealing with the practicalities. For example, we are considering whether Treasury Minutes revising the RRR could be submitted to Treasury Ministers for approval in batches during the course of 2003-04 with effective dates of 1 April 2003, or whether in practice, the effective date for most will be 1 April 2004.