How to Integrate Contingent Liabilities in Public debt Management Strategies?

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Bio

- Dr Hans J. Blommestein, Head Bond Market and Public Debt Management Unit, OECD
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- Former Advisor IMF missions to Central and Eastern Europe and the Former Soviet Union
- Past Visiting scholar IMF research department

IMF High-level conference on Fiscal Risks, 28-29 October 2008
OECD WPDM

- Policy Forum for Senior Debt Managers OECD countries with IMF and WB as observers
- Annual Meeting of the WPDM
- The Annual OECD Global Forum on Public Debt Management
OECD Work On Contingent Liabilities

- Working Party has compiled authoritative pool of knowledge on leading debt management practices, incl. the issuance and management of guarantees
- Report on best practices in managing guarantees prepared by experts’ group of OECD Working Party on Debt Management
Advances in Risk Management of Government Debt

Advances in Risk Management of Government Debt is a landmark study about risk management practices of OECD debt managers. Risk management has become an increasingly important tool for achieving stronger debt targets and is now an integral part of a wider strategic debt management framework based on benchmark in most jurisdictions. However, the study shows that the extent and sophistication of risk management vary widely across countries.

This study brings together a number of recent reports on best practices for managing market risk, credit risk, operational risk and contingent liability risk. It was prepared by a collective of experts from the OECD Working Party on Public Debt Management and includes case-studies of risk management practices in selected OECD debt markets.


The full text of this work is available online via this link:

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OECD report: Best practices

- The OECD experts group’s mandate was to formulate a set of best practices in managing explicit contingent liabilities (guarantees).
- OECD Report is written from perspective of debt managers.
- But it also addresses how guarantees are treated more generally, in particular in budget legislation and processes.
Contingent debt in many ways similar to conventional government debt

• Like conventional bonds:
  – based on contracts under civil law
  – to be serviced using taxpayers’ money

• These general features suggest a link to the responsibilities of debt managers
OECD Report: Assessment guarantees (1)

- Important to assess alternatives to guarantees
- Comparison of credit guarantees with direct lending
- Key conclusion 1: credit guarantees have two drawbacks:
  1. guaranteed debt has higher funding costs
  2. guarantees may entail higher financial risks
OECD Report: Assessment guarantees (2)

- Key conclusion 2: credit guarantees must bring advantages that outweigh these drawbacks.
- Two sets of potential benefits:
  1. possibility to use guarantees in a way that allows the government to share credit risks with lenders
  2. there may be administrative benefits from involving outside lenders in a government-sponsored program
Sound governance system

- Rules for transparent reporting of costs of guarantee
- Same rules as decisions on direct use of government resources (explicit fees)
- Problem with public accounting systems
- Guarantee portfolio should be published regularly in a transparent + consistent fashion
- Linked to conventional debt portfolio
Valuation principles guarantees

- Fees based on expected cost of guarantee
- Charging less than market value results in a state subsidy
Role of debt managers (1)

• Why do debt managers have a key role in sovereign risk management involving guarantees?
• Contingent debt is latent form of government debt
• Measures of cost and risks that encompass both guarantee portfolio and regular debt portfolio
• Debt managers well positioned to manage joint portfolio
Role of debt managers (2)

• Integration of conventional and contingent debt management
• Conventional debt portfolio plays key role in adjusting overall debt structure
• Both parts of debt portfolio need to be included in risk management process
Role of debt managers (3)

- Importance of central risk management
- Balance sheet approach
- But: important off-balance sheet items such as contingent liabilities should be included as well
- Prospects for SALM?
Conclusion: key requirements on the use of guarantees

- Key requirements of a sound governance system
- Proper pricing
- Central risk management function
- Sovereign balance sheet approach (SALM)
- Appropriate rules and guidelines for guarantee issuance
Selected publications

Next event OECD WPDM

- Topics include SALM
- Target audience: Debt Managers
- By invitation only
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