Contingent Liabilities
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• Interest in Contingent Liabilities/State Guarantees has heightened noticeably,
  – Global financial crisis
  – Bail-out of banks
  – Deposit insurance schemes
  – Fannie Mae, Freddie Mac, AIG etc.
  – SOE´s, PPP´s etc.

• Fiscal risk has increased because of global financial crisis
  – increased contingent liabilities
  – change in the role of the government
    • from a supplier of public services
    • to a facilitator extending guarantees to public & private sector
Contingent Liabilities

- Contingent Liability – not an obligation to pay unless a certain discrete event(s) occurs. Therefore often referred to as off-balance sheet item.
- State guarantee = Contingent Liability
  - however contingent liability not necessarily a guarantee, e.g.
    - indemnities
    - potential legal claims from pending court cases
- Contingent liabilities can be explicit or implicit
CL - Explicit vs. Implicit

• Explicit – specific obligations of the government that is established by law or a contract authorized by law

• Examples
  – loans and obligations of SOE
  – mortgage / student / agriculture loans etc.
  – civil service pensions
  – Central Bank obligations
  – deposit insurance etc. (is established by law)
Explicit vs. Implicit

- Implicit – moral obligation or expected responsibility usually recognized after an event or condition is realized

- Examples:
  - default of municipalities
  - bank failure (bail-out)
  - deposit insurance
  - failure of a non-guaranteed pension fund
  - natural disaster relief
• Legislation necessary to ensure
  – proper authority for issuance of state guarantees
  • who can issue state guarantees – Parliament, Ministers, Institutions etc.
  • what preconditions need to be in place for legitimate issuance of state guarantees
  • who can receive state guarantees
  • institutional settings for issuance, monitoring and reporting
  • fee structure and its reasoning
  • penalties for non-conformance by receiver of state guarantee
CL – Legal environment

• Legislation necessary to ensure (cont.)
  – proper procedure for maintaining state guarantees
    • disclosure requirements for state guarantees
    • reasons and procedures for withdrawal of state guarantee
      – state guarantee can be suspended, but
      – already existing guarantees impossible to withdraw from
    • fee collection (state-aid considerations)
    • risk monitoring and reporting
    • compliance with international obligations (EU/ESA)
• The institutional framework is best set up by the Legislature, where institutional authority is designed to
  – facilitate request for information from entities that enjoy or will possibly enjoy state guarantees
  – establish institutional monitoring of state guarantees and follow-up w.r.t. violations
    • explicit state monitoring
    • external monitoring
    • limits monitoring
  – legitimize the use of penalties for non-conformance, i.e. a mandate to intervene if size or risk getting to large
Transparency

- Transparency is important
- Regular publishing of data on State Guarantees
- Publishing of all relevant data concerning new state guarantees
- Off-balance sheet items numerated at least annually in the Treasury’s annual accounts
- Some information are too sensitive to be disclosed
The requirements for obtaining a state guarantee are set by an act of Parliament.

The Parliament can therefore, if it so chooses, change the law and set new requirements when issuing new state guarantees.

Therefore it is very important that the Parliament has full information regarding possible new state guarantee – members of Parliament need to be fully aware of possible ramifications and risk for the Treasury regarding new state guarantees.
Discussion points

• Legal framework for contingent liabilities – how should it be set up in order to ensure transparency?
• Institutional framework – to ensure transparency and accountability as well as informational correctness?
• Informational disclosure – explicit contingent liabilities should be obvious, but how about implicit CL. How much should be disclosed, is there some line that should not be crossed, some information's that are too sensitive to be disclosed?
• Under what circumstances are CL in the form of government guarantees most useful and what should be avoided?