

The perspective of the OECD Working Party on Debt Management on Guarantees

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First OECD Forum on African Public Debt Management

- **Session V.A. 3: Role of debt managers in managing contingent liabilities**
- **Report on best practices in managing guarantees prepared by experts' group of OECD Working Party on Debt Management**
- **Members: Senior Debt Managers 30 OECD countries plus IMF and WB as observers**
- **Working Party has compiled authoritative pool of knowledge on leading debt management practices, incl. guarantees**

Advances in Risk Management of Government Debt

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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 strategic debt targets, and is now an integral part of a wider strategic debt management framework based on benchmarks 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 authors from the OECD Working Party on Public Debt Management, and includes case-studies of risk management practices in selected OECD debt markets.

Related publications by the OECD Working Party include *OECD Public Debt Markets: Trends and Recent Structural Changes* (2002) and *Public Debt Management and Government Securities Markets in the 21st Century* (2002). In parallel, the OECD publishes *Central Government Debt: Statistical Yearbook*.

The full text of this book is available on line via this link:
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Contingent debts in many ways similar to conventional government debt

- Like conventional bonds:
 - based on contracts under civil law
 - to be serviced using taxpayers' money
- In these respects, immediate links to the responsibilities of debt managers

Best practices

- The OECD experts group's mandate was to formulate a set of best practices in managing explicit contingent liabilities (guarantees)
- Report is written from perspective of debt managers
- But it also addresses how guarantees are treated more generally, in particular, in budget legislation

Assessment guarantees (1)

- **It is important to assess alternatives to guarantees**
- **Comparison of credit guarantees with direct lending**
- **Conclusion: credit guarantees have two drawbacks:**
 1. **guaranteed debt has higher funding costs**
 2. **guarantees may entail higher financial risks**

Assessment guarantees (2)

- Ergo: 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
- Linked to conventional debt portfolio

Valuation principles guarantees

- Fees based on expected cost of guarantee
- Charging less than market value =state subsidy

Role of debt managers (1)

- Debt managers have a key role in 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)

- Conventional debt portfolio play a key role in adjusting overall debt structure
- Both parts of debt portfolio need to be included in risk management process
- Central risk management