



AGENCE  
FRANCE TRÉSOR



## ***2nd OECD – China Forum on Public Debt Management***

*Xian, 15 & 16 September 2005*



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# ***The Ministry of Finance and the Government Bond Market: the Case of France***

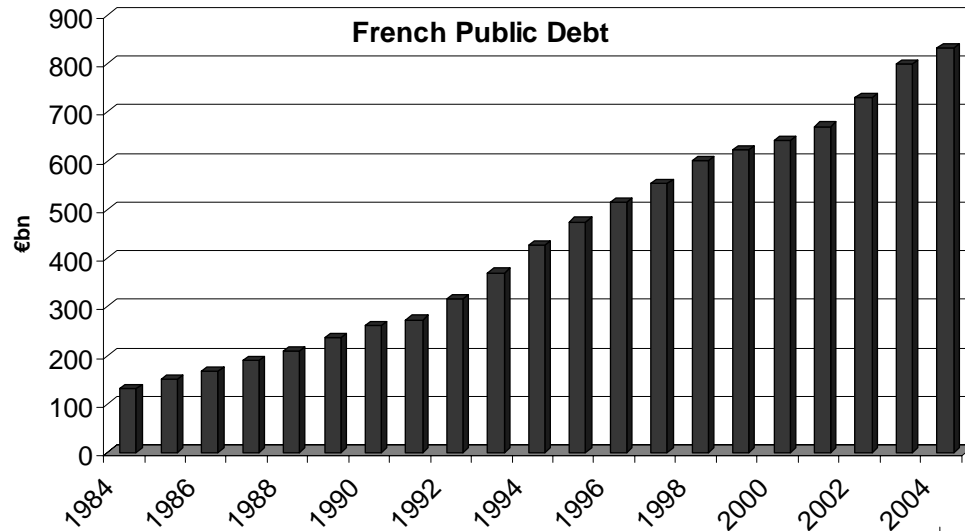
*Bertrand de Mazières*

*Chief Executive Officer, Agence France Trésor*



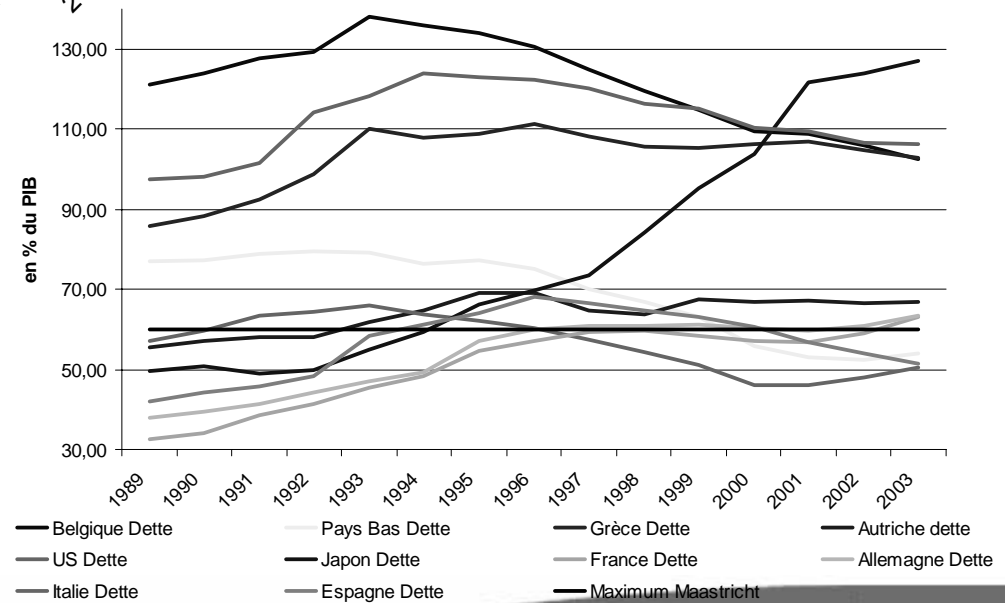
- 
- ❖ **The Need for a Bond Market**
  - ❖ **The Institutional Arrangement**
  - ❖ **The Management of the State Debt**
  - ❖ **Serving Both the State and the Market**

# An Increasing Debt...



Over the past 20 years,  
French Public Debt has increased  
sixfold

OECD Nations Debt has  
similarly increased



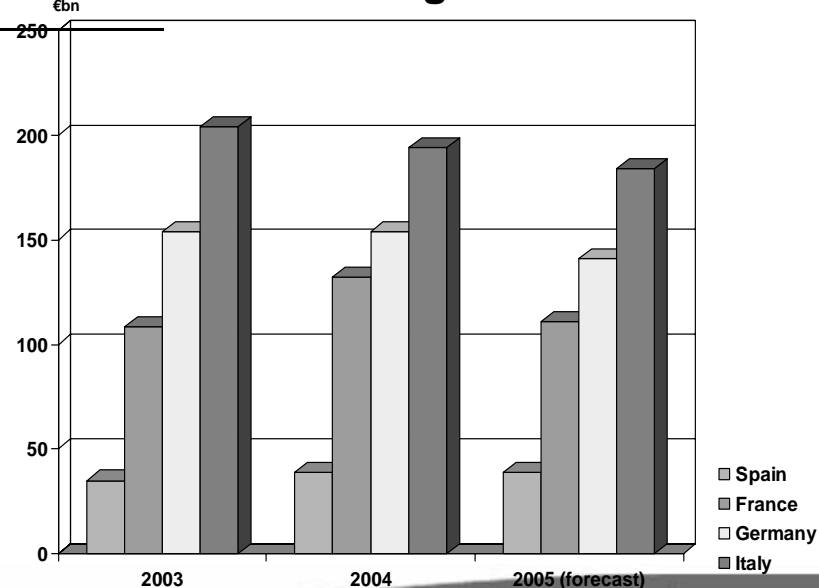
# And Increasing Funding Requirements

## French Borrowing Programme

€bn	2004	2005 (PLF)	2005 (funding prog. Dec 2004)
Redemption of Long-Term Debt	36.0	33.82 <sup>1</sup>	33 <sup>2</sup>
Redemption of Medium-Term Debt	30.5	39.32 <sup>1</sup>	33 <sup>2</sup>
Budget Deficit	46.9*	44.9	44.9
Total Funding Requirement	113.4	118.0	111.0

\* Funding requirement from January, 1<sup>st</sup> 2004 to December 31.  
 1 Before buybacks in Q4 2004 of securities maturing in 2005  
 2 After buybacks

## European Borrowing Programmes



Source: Treasuries, SVT, forecast end of 2004

# French Debt: Key Figures as of 31 July 2005

- Negotiable Debt Outstanding: €865.6bn
  - Long-Term (OAT): €589.8bn
  - Medium-Term (BTAN): €183.2bn
  - Short-Term (BTF): €92.6bn
  - Interest Rate Swaps Outstanding: €60bn
  
- Medium- and Long-Term net Financing Programme
  - 2003: €111.4bn
  - 2004: €122bn
  - 2005: €111bn
  
- Average Daily Cash Flows on State Bank Account: €22bn

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# Agence France Trésor: Mission & Status

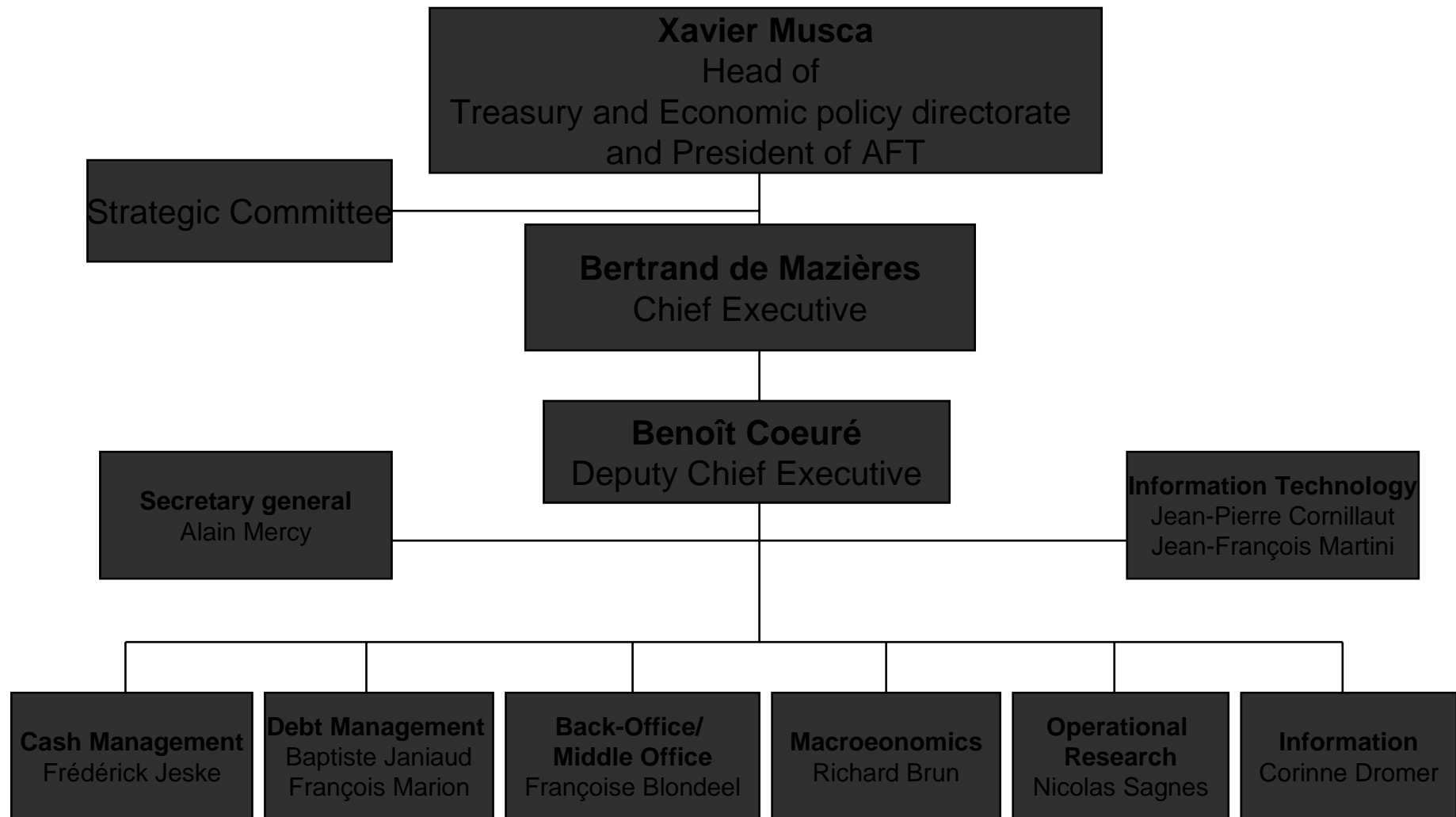
- Founding: Ministerial order. February 2001.
- Mission: to provide cost-efficient and secure debt and treasury management services.
- Status: a division of the Treasury Department operating under the authority of the Minister of the Economy, Finance and Industry.

# Agence France Trésor: Assignment

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- **AFT Main tasks:**
  - Debt management operations
  - Cash Management: short term borrowing or investment to manage lags between receipts and expenditures
  - Administration of transactions (middle & back office) and risk control
  - Market communication, intelligence and research (incl. in-house strategy unit)
  - IT
- **AFT Resources: Staff of 33 people; Budget of €8.6 M**
- **What AFT doesn't do:**
  - Administration of debt and treasury of non-State public sector: local authorities, State companies and institutions, Social Security ;
  - Global ALM for the State.

# Agence France Trésor: Organization Chart



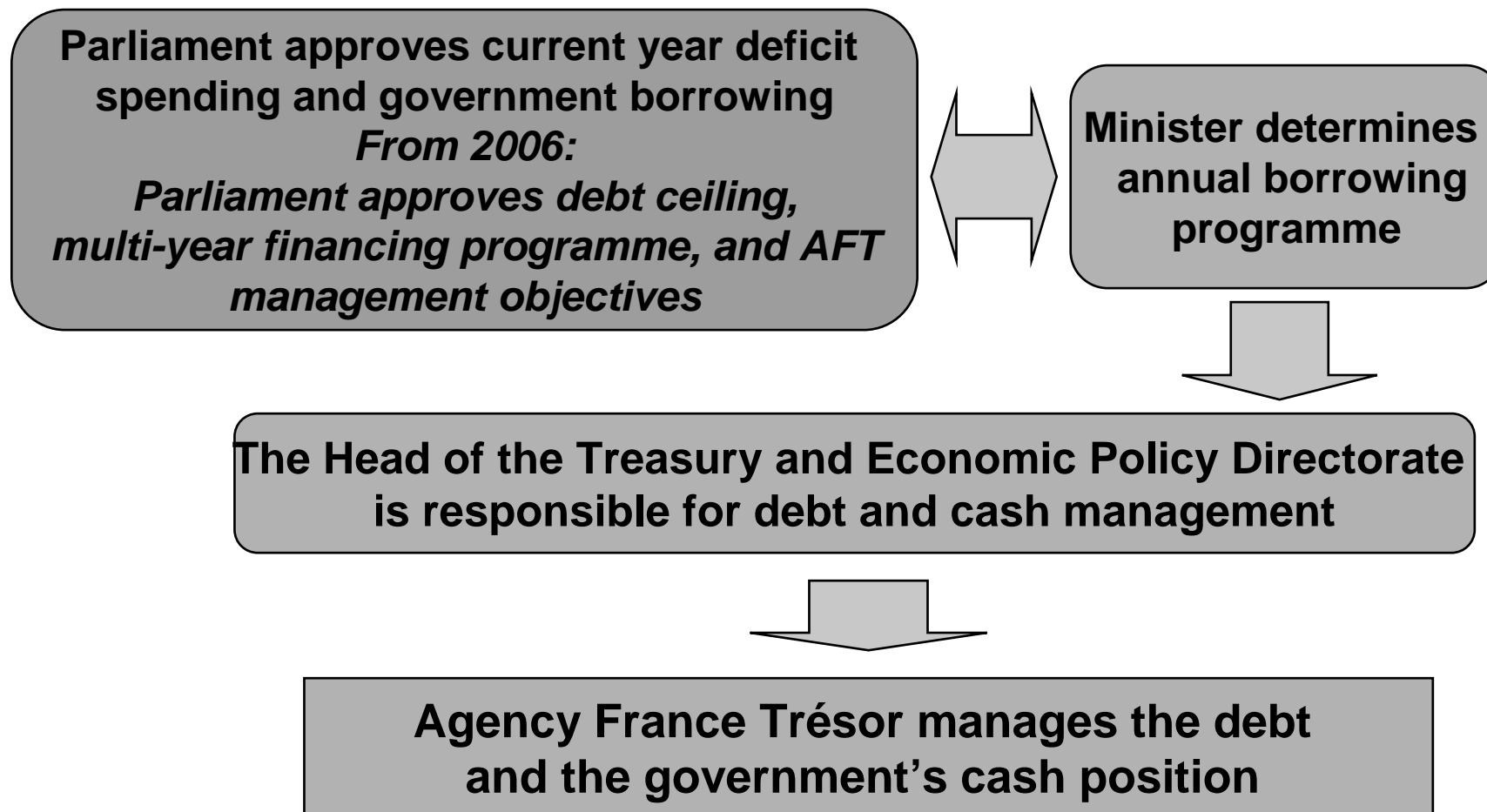
# AFT: Governance

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- **Democratic Accountability:** AFT's borrowing programme is set by and reported to Parliament every year.
- **Administrative Responsibility:** AFT is part of MOF ; AFT staff are State agents.
- **Operational Management:** AFT contracts with partners.
- **Expertise building:** a Strategic Committee meets at least twice a year to review achievements and projects.
- **Control:** legally enforced external audits.

# AFT Accountability to Parliament (1)

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# **AFT Accountability to Parliament (2): 2 Crucial New Features of Budget Laws as of 2006**

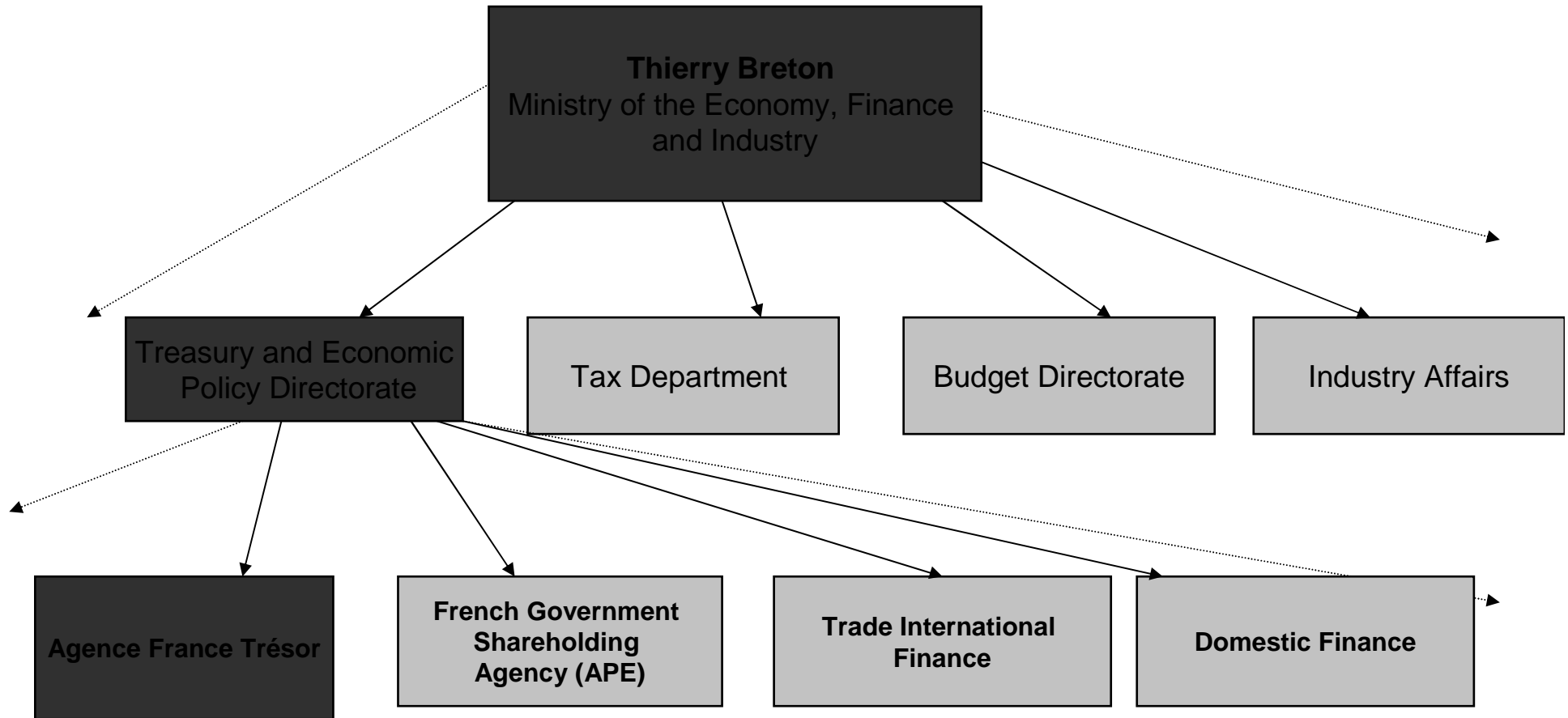
- The Organic Law on Budget Bills (art. 34) states that “*The Budget Bill establishes the ceiling of the net variation, as observed at the end of the year, of the marketable debt of the State with maturity exceeding one year.*” This article takes effect in 2006.

- On November 17, 2004, US Secretary of the Treasury John Snow wrote to the U.S. Congress that “*a debt issuance suspension period would begin on November 17 and last until December 2*”

Can this happen in France ?

- The new debt ceiling will be less stringent than in the United States:
  - It will not constraint the buyback policy (“net variation” = gross issuance less buybacks)
  - It will not paralyse AFT in case of an unexpected increase in the deficit (“maturity > 1 year” = OAT and BTAN, meaning that AFT can issue BTF to fund the deficit)
  - The debt ceiling can be breached in the course of the year if the government brings issuance down before year-end

# Administrative Responsibility Belongs to MoF



# Why to Establish a Specialised Agency within MoF ?

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- Practical reasons: to set up a new institution is a way to facilitate investment in IT and/or recruitment of staff with financial markets experience.
- An Instance of Administrative Reform and Modernisation : to set up a new institution within, and not outside, MOF offers opportunity to
  - prevent possible conflicts of interest within MOF with a separation of the daily operations the State as (i) issuer (ii) policy maker (iii) regulator and (iii) shareholder ; “the markets knows who they are talking to”.
  - preserve the coherence of State operations
- More effective operational arrangements with third parties : to set up a specialised agency with the power to contract facilitates the conclusion of agreements with business partners
  - AFT enters into agreements with the central bank acting as the State’s bank account holder ; with the financial utilities and professional organisations ; with the banks ;
  - AFT applies regulations in place (i) for public tender offers when selecting a contractual partner (ii) for its operations and transactions.

# Operational Arrangements with the Central Bank

- Banque de France is the State's only banker  
Article 101 of the European Union Treaty expressly prohibits any cash advance by Banque de France to the State.
- May 2002 Convention with Banque de France implements 4 principles for a best possible quality service :
  - Real-time accounting of operations and ongoing availability of related applications
  - Safety of operations with a strict definition of the working hours
  - Regular information throughout the day and with monthly follow-up meetings
  - Financial neutrality : Banque de France will compensate for any loss incurred by the State in case of service disruption or operational mistakes.

# Operational Arrangements with Banks: Primary Dealership

Since 1987, France has resorted to primary dealers for the placement of its securities, the SVTs (Spécialistes en Valeurs du Trésor). AFT – SVTs relations are organised by a Charter that states mutual obligations:

- SVTs are committed to participate in auctions, to maintain a liquid secondary market and report their activity to AFT

*they are required to participate in all auctions and to account for at least 2% of volumes auctioned on average on any 12-month period*

*they must account for a significant share of grey and secondary markets and display bid and offer prices on the main securities ; the same applies to the repo market*

*they are asked to offer services such as direct access to economists, sales and strategists, organisation of investors meetings, membership of custody and settlement system (EUROCLEAR)*

*they report their trades on a monthly basis, in a aggregated manner (currently under harmonisation within the € Zone)*

*they must adhere to a Good Conduct Rulebook and should submit to audit by AFT and or the French Banking Commission*

- AFT will select syndicate members among SVTs, will assess their performance every year on a uniform set of criteria (quantitative achievements on the primary and secondary markets, 5 qualitative criteria) and make their ranking public... for the best ones only !

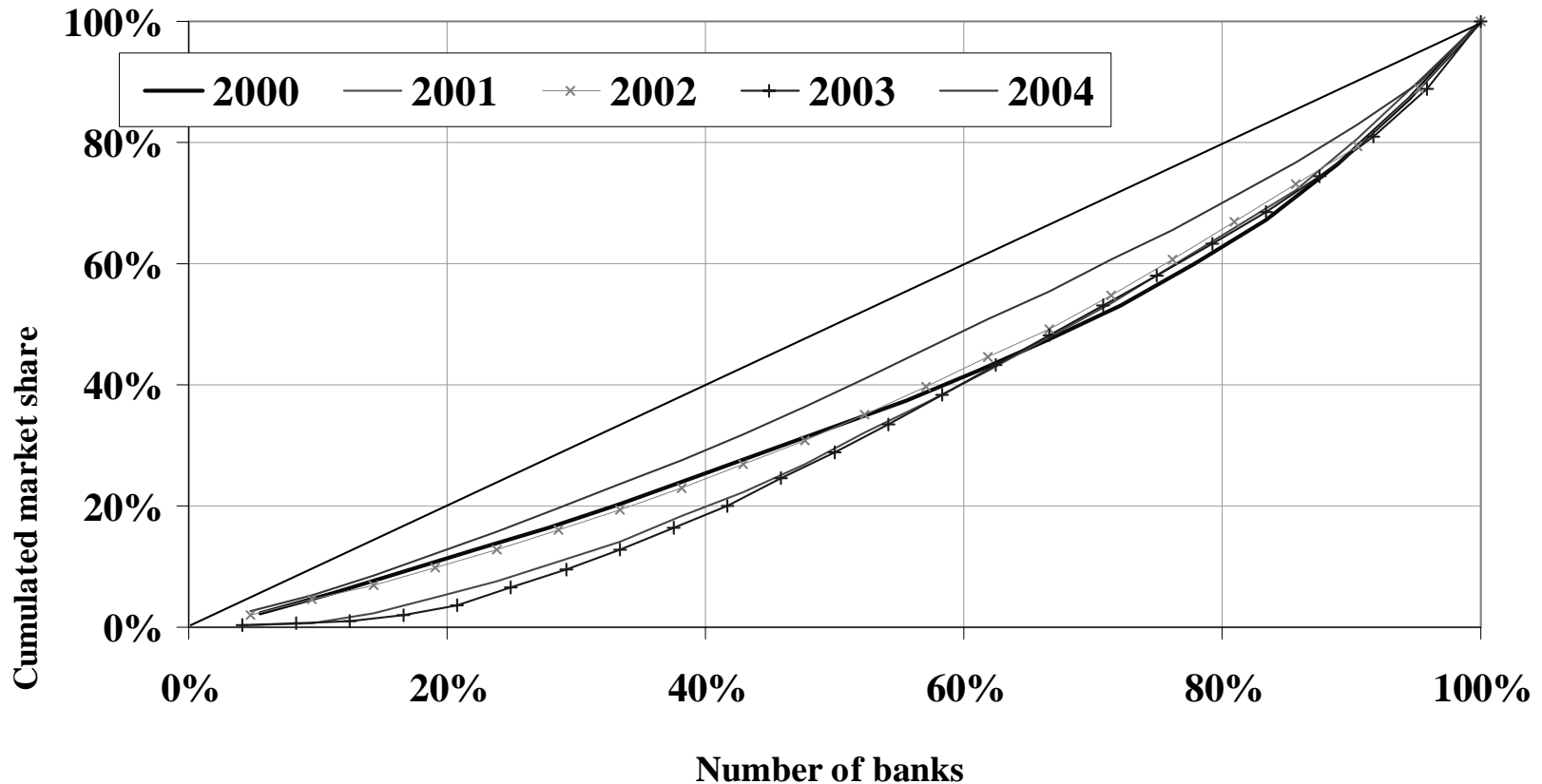
# Primary Dealership & Bond Markets Functioning

- Selection of SVTs every 3 years + annual assessment have had an impact on market practices : most € Zone States have adopted similar models. Some corporates too.
- France has not expressed any views on the right number of SVTs. Implicit need for a balance between cost and advantages seem to have developed in a “natural membership” of around 20 banks.
- Common criteria of performance has not translated into business clones : SVTs strategies are diverse. AFT welcomes this diversity but monitors developments through dialogue with each partner.

# Exemple of SVTs Diverse Strategies: Evolution of Market Shares for 5 SVTs between 2001 and 2004



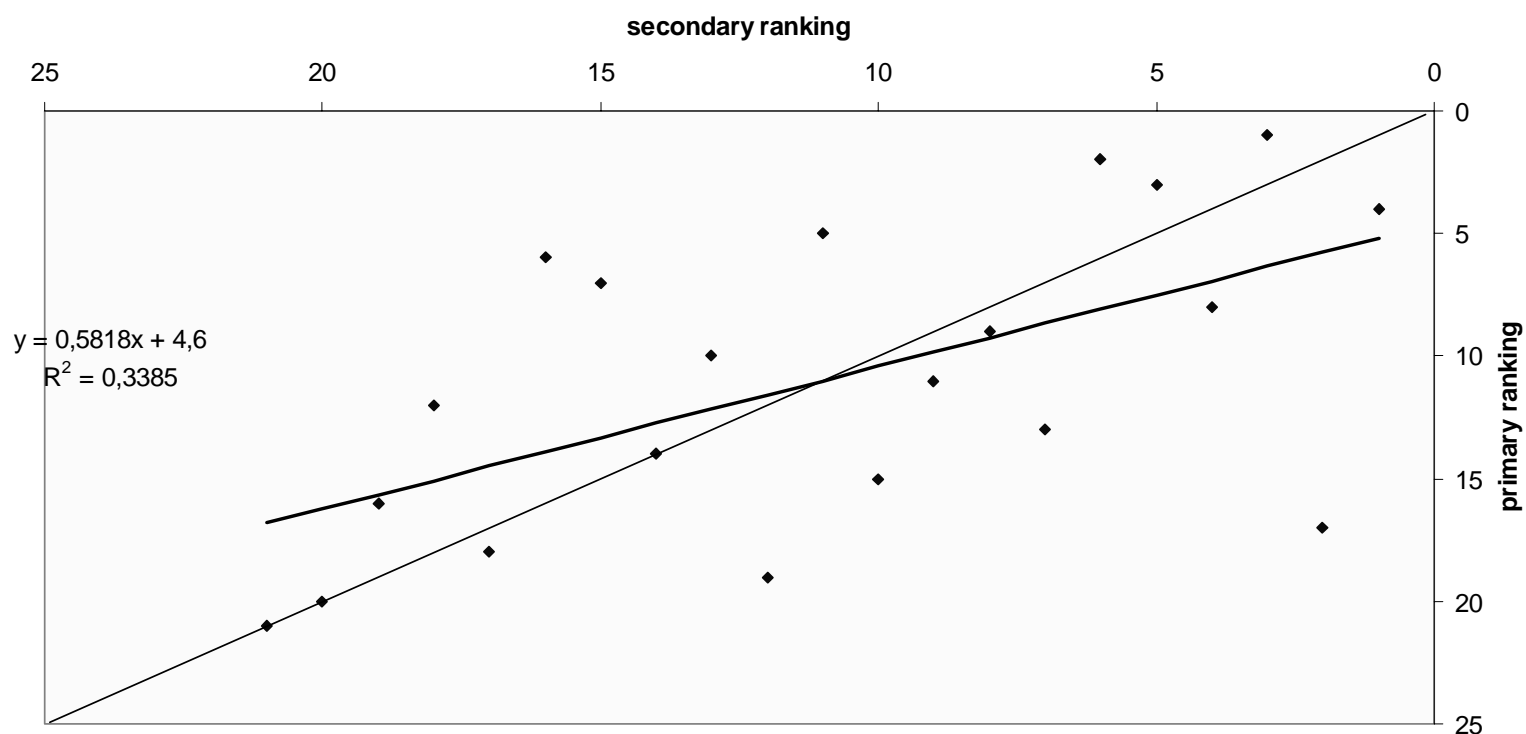
Concentration of the Treasury primary market : Lorenz curve



Note : The Lorenz curve represents the cumulated market share of a given number of banks.



# A Variety of Marketing Strategies



# Expertise Building & Support: AFT Committees

- **Strategic Committee** : 9 members with senior experience / expertise in world financial markets ; geographic diversity (from France, Italy, USA, Singapore). At least 2 meetings a year.

*Example of recent agendas : elaboration of performance criteria and risk control indicators ; duration policy ; buy-back optimisation ; optimal share of inflation-linked bonds ; contingency planning ; security of repo market operations.*

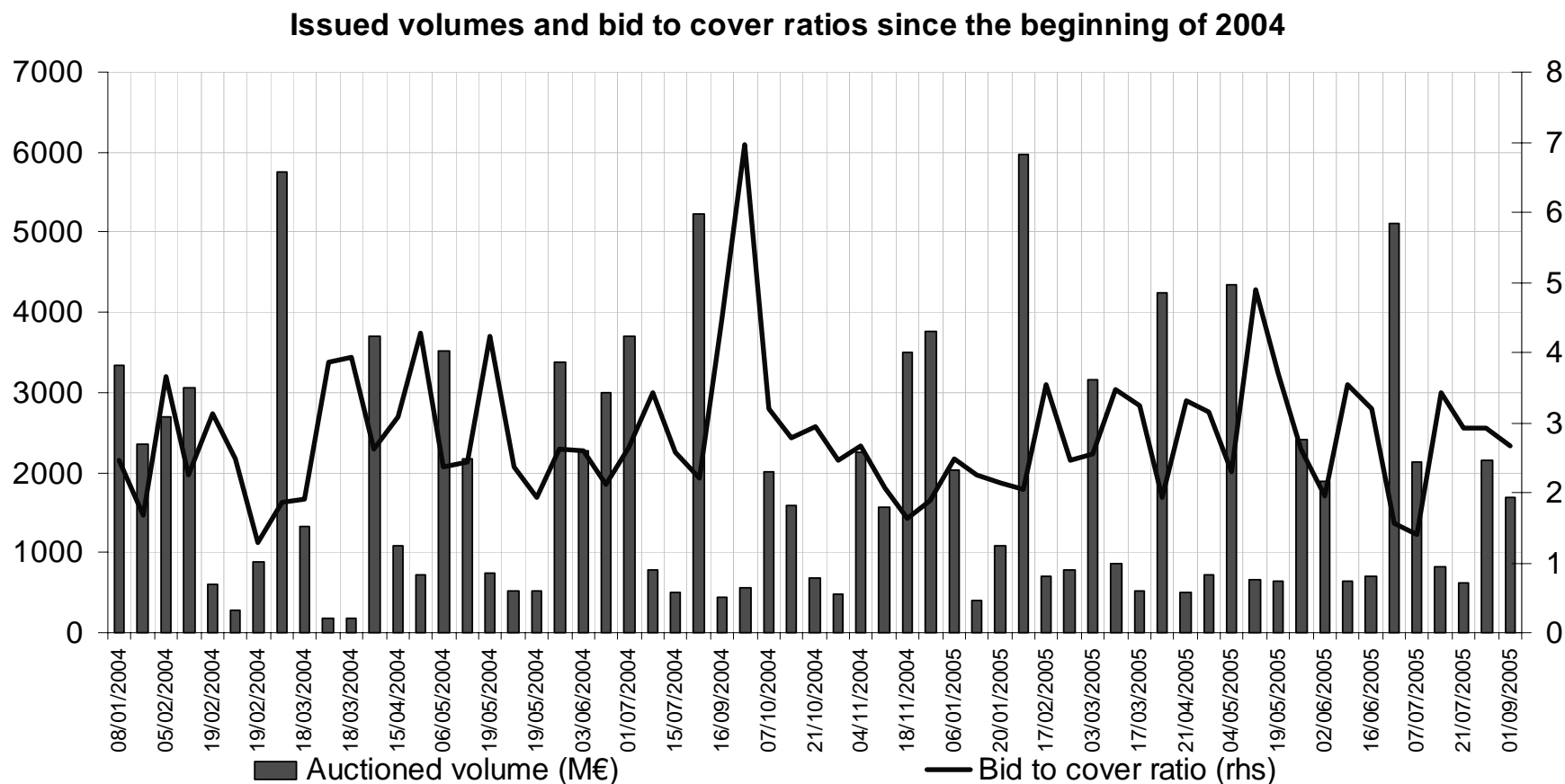
- AFT also relies on ad hoc collective advisory panels for major decision : SVT selection committee (to be next convened in June 2006) ; IT investment committee.

# AFT Control & Oversight: Performance Criteria Reported to Minister & Parliament

<b>Debt Management</b>	Implementation of the financing programme	- covered auctions; - bid to cover ratio
	Benchmark indicators	- timing indicator - allocation indicator
	Reduction of debt average maturity	- Debt average maturity (after swaps)
<b>Cash management</b>	Obtaining the best return on the cash surplus	- interest rates on lending, - interest rate on repo operations
	Limiting the level of the Treasury Account at the end of the day	Level of the account at the end of the day.
	Information of AFT by local authorities of their financial operations	Level of announcement
<b>Risk control</b>	Constant quality level of risk control in order to minimize the occurrence of incidents	- quality of control system, - Incidents in executing debt and treasury operations

# Debt Management Indicators: Auction Coverage Ratio

The risk of not covered auction remains under control:



# Debt Management Indicators: Market Timing, as of May 15, 2005

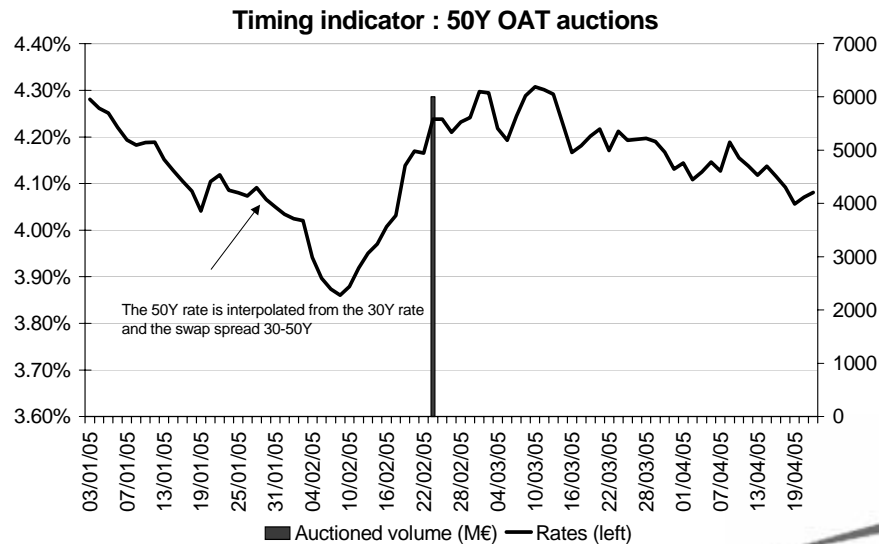
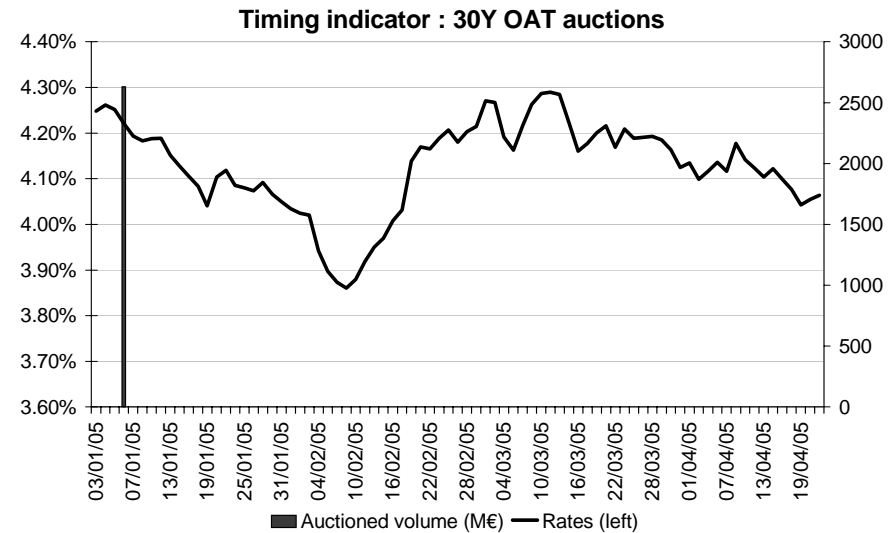
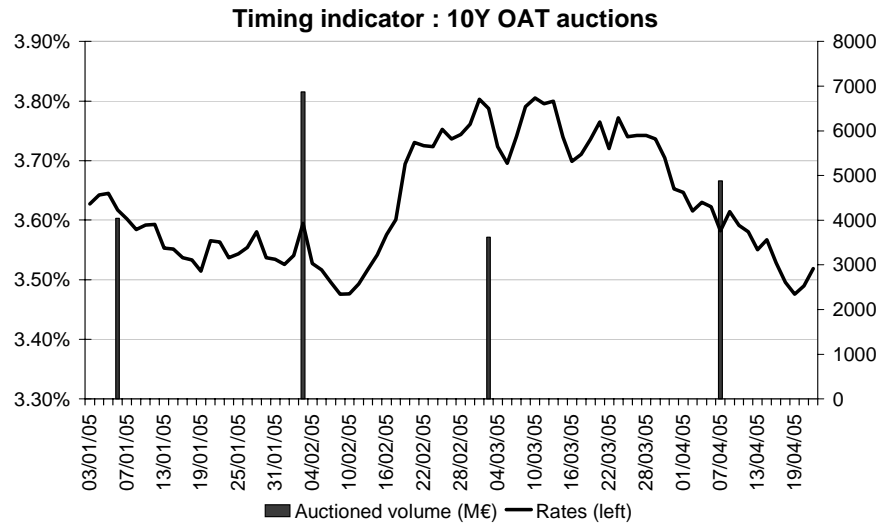
The actual issuance policy is compared to the systematic issuance, every business day, of a constant volume of securities

2005		Volumes auctioned	Results (10yr equival., bp)
Auctions	BTAN 2 y	12 692	0.1
	BTAN 5 y	8 775	-0.3
	OAT 10 y	19 405	1.1
	OAT 15 y	4 343	-0,2
	OAT 30 y	2 629	1.1
	OAT 50 y	6 000	2.1
	Linkers	5 826	-0.2
<b>Total</b>		<b>55 327</b>	<b>3.7</b>

+ *underperformance*

- *overperformance*

# Market Timing: 10Y, 30Y and 50Y Auctions, as of May 15, 2005



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# Debt Management Indicators: Allocation, as of May 15, 2005

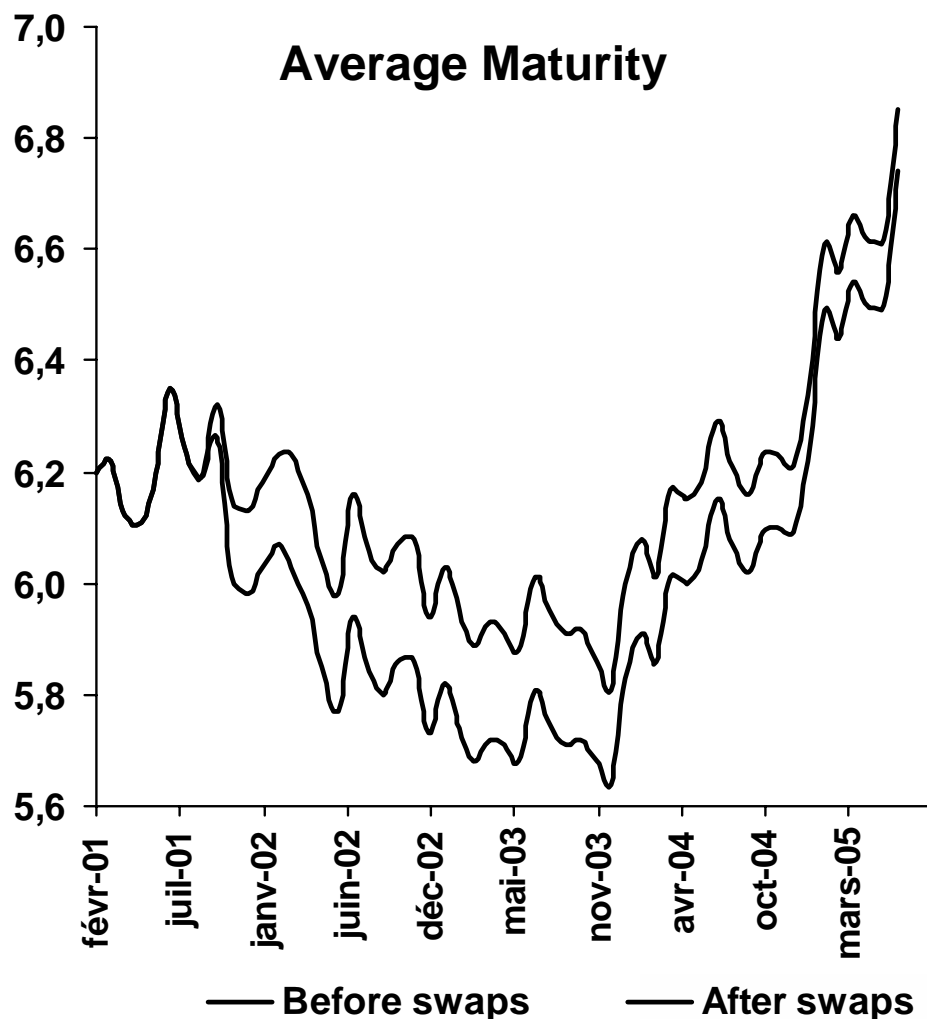
The actual issuance policy is compared to the issuance schedule as of 1/1/2005

2005		Volumes auctioned	Results (10yr equival., bp)
Auctions	BTAN 2 y	12 692	0.1
	BTAN 5 y	8 775	- 0.2
	OAT 10 y	19 405	2.9
	OAT 15 y	0	-1.5
	OAT 30 y	2 629	0.1
	Index- linked OAT	5 826	-0.5
<b>Total</b>		<b>55 327</b>	<b>0.3</b>

+ *underperformance*

- *overperformance*

# Debt Management Indicators: Average Maturity



- In 2001: €37.2bn
  - 85 deals: €438m
  - Receiver: 8.6 years
  - Payer: 3.4 years
  - Duration cut: 54 days
- In 2002: €24bn
  - 56 deals \* €430m
  - Receiver: 7.7 years
  - Payer: 3.0 years
  - Duration cut: 30 days
- Implementation suspended in August 2002 due to market conditions
- In 2003: €10bn
  - Payer: 2.0 years
- In 2004: €12.5bn
  - Payer: 2.5 years

# Treasury Management Indicators

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	Target set in the 2005 Budget Bill	Results as of August 1, 2005
LENDINGS	EONIA	EONIA-0.0007%
REPO	SWAP EONIA-0.02%	SWAP EONIA-0.005%

# Risk Control: Performance Indicators (1)

		2003	2004	2005	2006	2007
<b>Internal Rulebook misimplementation</b>	Value	achieved	achieved	target	target	target
<b>External auditor's appraisal</b>	N. of occurrences	Na	0	0	0	0
Transaction and operation monitoring	Mark between 1 & 4	2	2	2	2	1
Quality of transaction accounting and reporting		1	1	1	1	1
Risk and result measurement		1	1	1	1	1
Risk monitoring systems		1	1	1	1	1
Documentation		2	1	1	1	1

## Risk Control: Performance Indicators (2)

Number of operational troubles with negative impact on the Banque de France Account balance							Impact on balance in thousands €		
Type of trouble		2003	2004	2004	2005	2006	2004	2005	2006
	Number of cases	Observed	Forecast	Observed	Forecast	Target	Observed	Forecast	target
Fails/errors on repos		0	Na	0	0	0	0		
Fails/errors on other transaction (swaps, auctions...)		1	Na	0	0	0	0		
Others (margin calls...)		2	na	2	0	0	0		

## Risk Control: Performance Indicators (3)

Number of operational troubles with NO negative impact on the Banque de France Account balance							Impact on balance in thousands €		
Type of trouble		2003	2004	2004	2005	2006	2004	2005	2006
	Number of cases	Observed	Forecast	Observed	Forecast	Target	Observed	Forecast	target
Fails/errors on repos		28	Na	39	20	10	0		
Fails/errors on other transaction (swaps, auctions...)		0	Na	0	0	0	0		
Others (margin calls...)		0	na	2	0	0	0		

# Risk Control: Performance Indicators (4)

Number of IT Troubles							Impact on Banque de France account in thousands €		
Type of trouble		2003	2004	2004	2005	2006	2004	2005	2006
	Number of cases	Observed	Forecast	Observed	Forecast	Target	Observed	Forecast	target
AFT IT failures		0	Na	0	0	0	0		
3rd party IT failures		3	Na	4	0	0	0		
Telecom failures		3	Na	1	0	0	0		
Others		0	na	0	0	0	0		

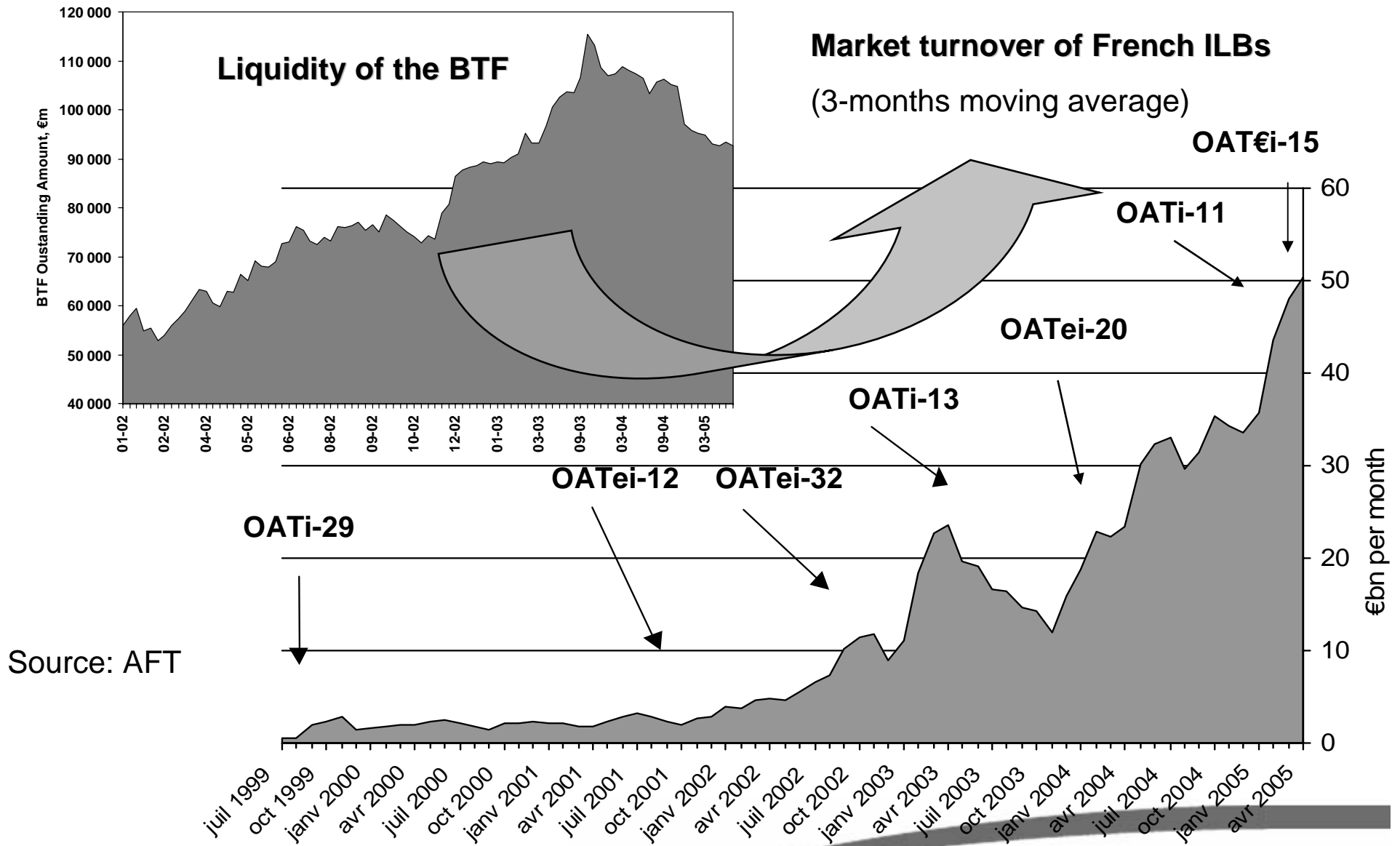
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# AFT's Mandate Shapes a Strategy

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- Our mission: AFT is tasked with handling government debt and cash management under the most secure conditions in the best interest of the taxpayer.
- Our strategy to achieve this goal is not opportunistic. AFT does not try to beat the market.
- Our commitments:
  - highest liquidity standard
  - transparency
  - relevance
  - and innovation

# Highest Liquidity Standards



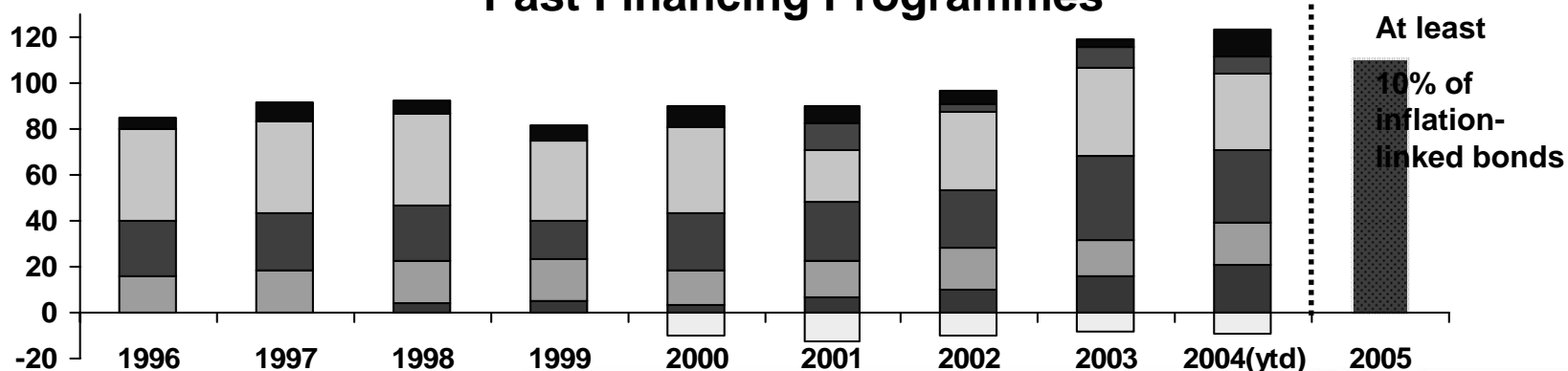
Source: AFT

# A Regular Financing Programme

Amounts issued (€bn) – as of 31 July, 2005

	Jan	Feb	Mar	April	May	Jun	Jul	Sep	Oct	Nov	Jan 05	Feb 05	Mar 05	Apr 05	May 05	June 05	July 05	
2 Y		1.2	6	2.7	3		1.5	1.9	1.9		1.5	5.8	2.9	2.5	2.3			1.9
5 Y	6.4	4.2		3.6	2.3	5.9	3.7	2.8	2.8	5.2	4.4		2.3	2	2.4	6.2		2.7
10 Y	3.5	2.7	6.6		3.5	3.4	4.2	5.2	2.4	2.2	4	6.8	3.6	4.9		2.5		5.57
15 Y		3.9			2.2				1.8						4.34			
30 Y										1.6	2.6	6				2.46		2.78
+ 50 Y	3			3.7		2.9												
OAT i / €i	4	1.9	1.9	1.9	2.1	3.4	1.5	1.2	1.3	3.5	1.7	1.5	1.4	1.4	1.3	1.5		1.6

## Past Financing Programmes



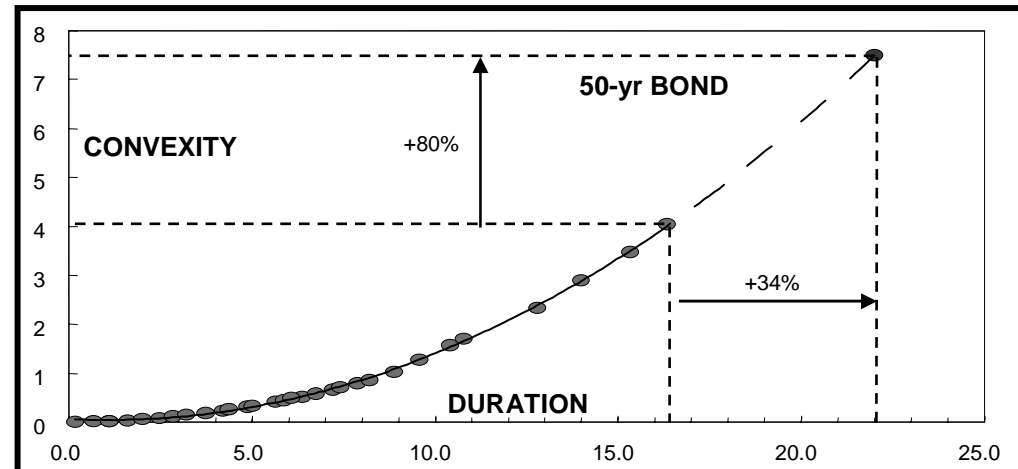
■ OAT i and €i ■ BTAN 2y ■ BTAN 5y ■ OAT 10y (net) ■ OAT 15y ■ OAT 30y ■ ML Term ■ buybacks

# Commitment to relevance: Example #1

## Assessing Market Potential Demand for 50-yr Securities

- Bonds with higher convexity will outperform if interest rates rise or fall
- The potential for volatility to rise from current low levels increases the attractiveness

	OAT 2015	OAT 2019	OAT 2023	OAT 2035	50-yr OAT
<b>Duration</b>	8.22	9.57	10.77	16.33	~ 22
<b>Convexity</b>	0.87	1.28	1.70	4.04	>7



	Pension Funds	Insurers	Banks (ALM)	Asset Managers	Hedge Funds	Swap desks
<b>Matching of long-dated assets</b>	✓ ✓ ✓	✓ ✓	✓			✓ ✓
<b>Arbitrage: -convexity -duration</b>	✓ ✓ ✓	✓ ✓ ✓	✓	✓ ✓	✓ ✓ ✓	

## Commitment to relevance: Example #2

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### Linkers that Build the Real Curve

- 1998: 10yr French Linker OATi 2009  
*First ever euro-denominated linker*
- 1999: 30yr French Linker OATi 2029
- 2001: 10yr Euro Linker OAT€i 2012  
*First euro-zone linker*
- 2002: 30yr Euro Linker OAT€i 2032
- 2003: 10yr French Linker OATi 2013
- 2004: 15yr Euro Linker OAT€i 2020  
7yr French Linker OATi 2011  
10yr Euro Linker OAT€i 2015
- 2005: 10yr French Linker OATi 2017
  
- N.B. 2003: 22yr Greek linker, 5yr Italian linker  
2004: 10yr, 30yr Italian linkers

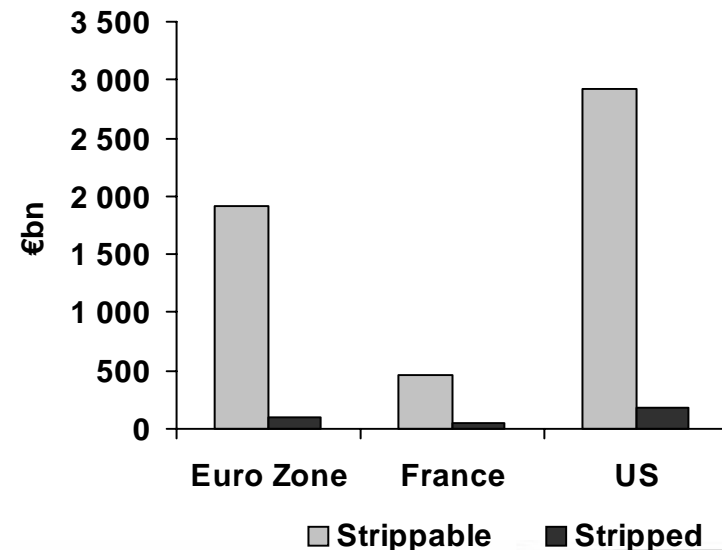
# Innovation

## A few Milestones...

- **1986:** Fungibility of Government Bonds
- **1989:** First 30-year OAT
- **1991:** First stripped OATs
- **1996:** First TEC-indexed OAT
- **1998:** First OAT indexed to French inflation
- **2001:** First OAT indexed to Eurozone inflation
- **2003:** First indexed OAT launched by auction
- **2005:** First 50-year OAT

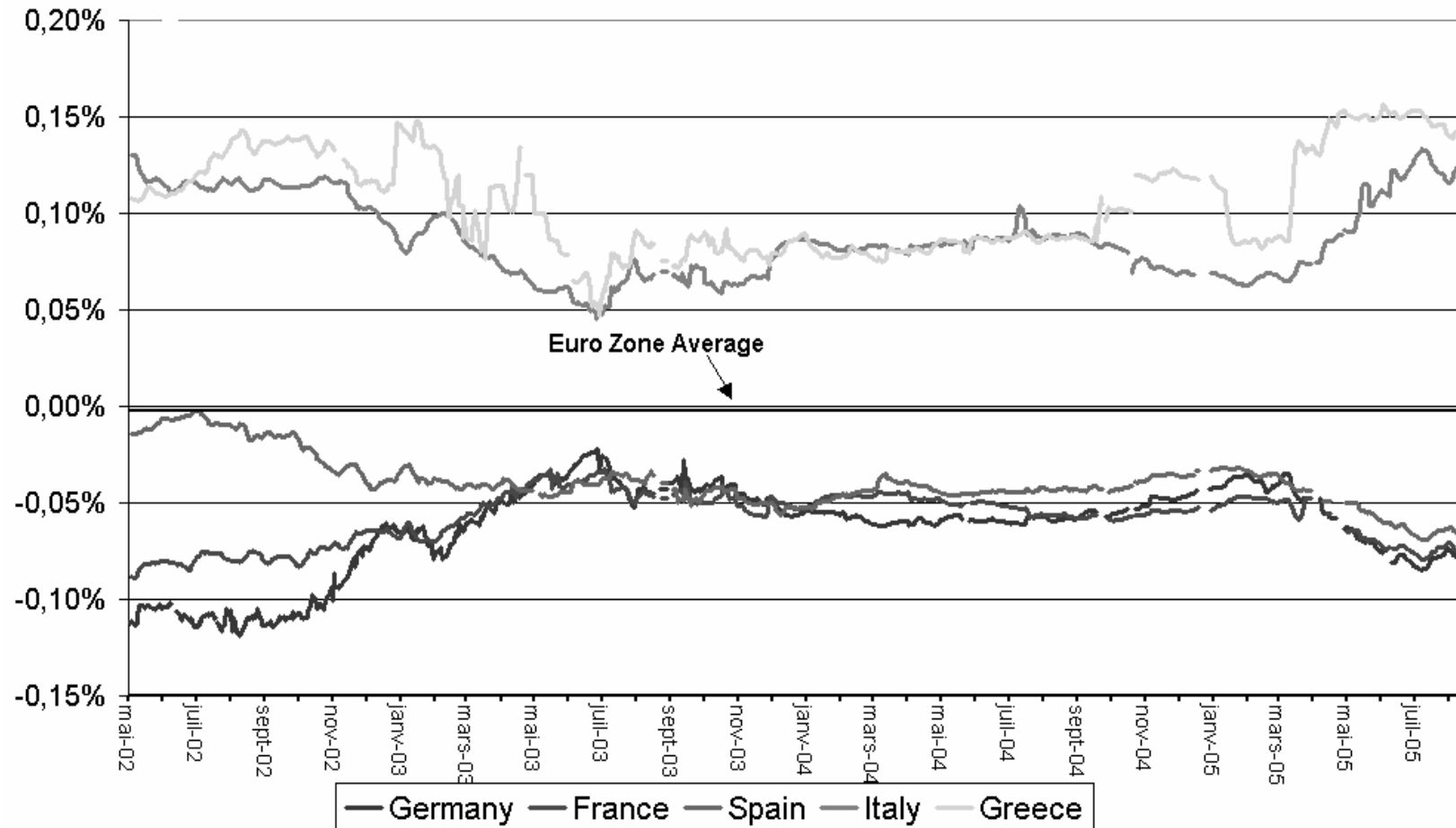
## The largest strips market in Europe

- Euroland strippable supply similar to US but stripped supply is lower.
- European strips market has room for growth due to pension and retirement fund demand
- French stripped bonds represent 50% of total outstanding strips within the Eurozone.



Source AFT, SVT, US Treasury

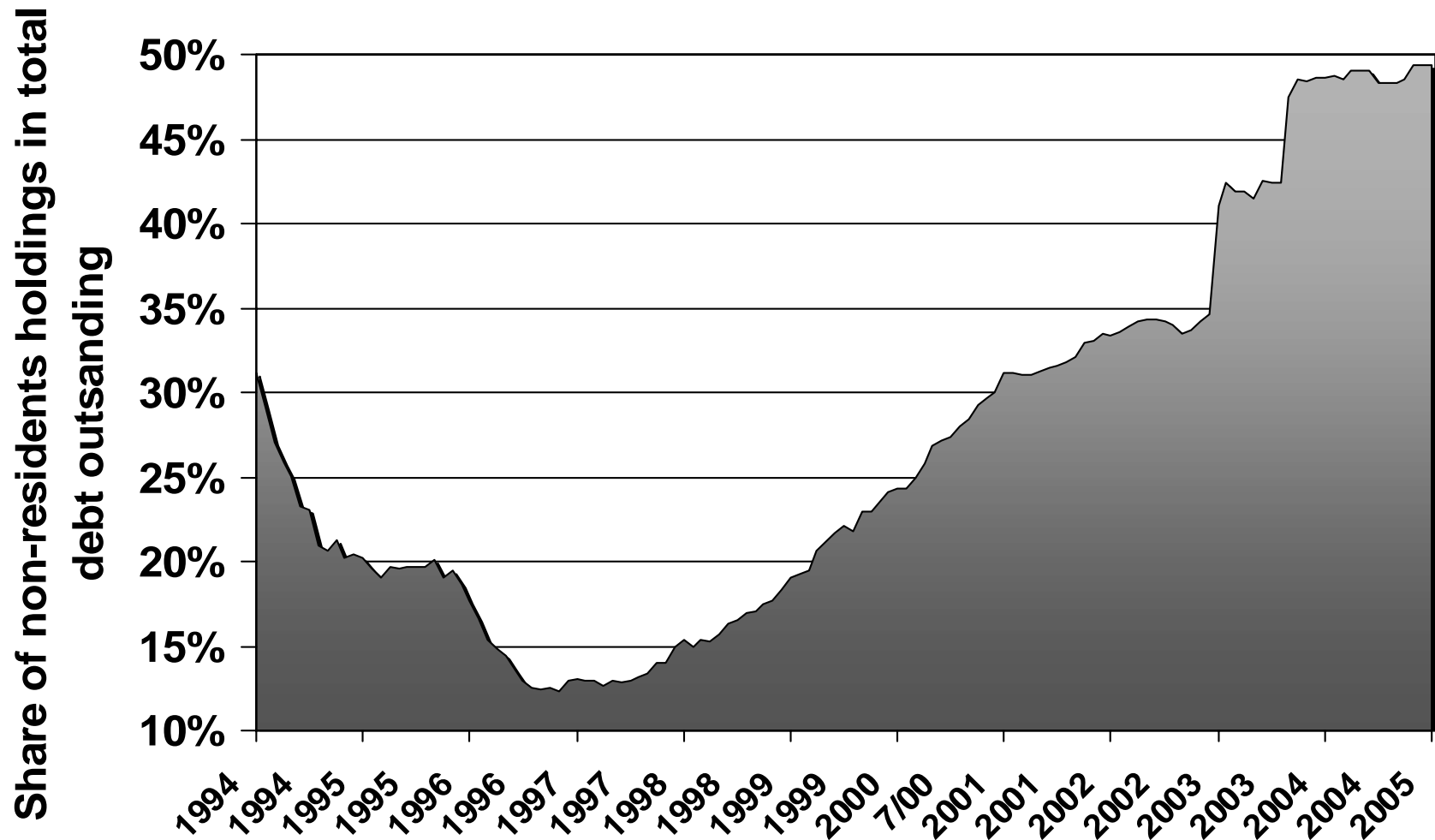
# Spreads in Core Eurozone Countries (August 2005)



Source: AFT

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# Sustained Interest from Non-French Investors



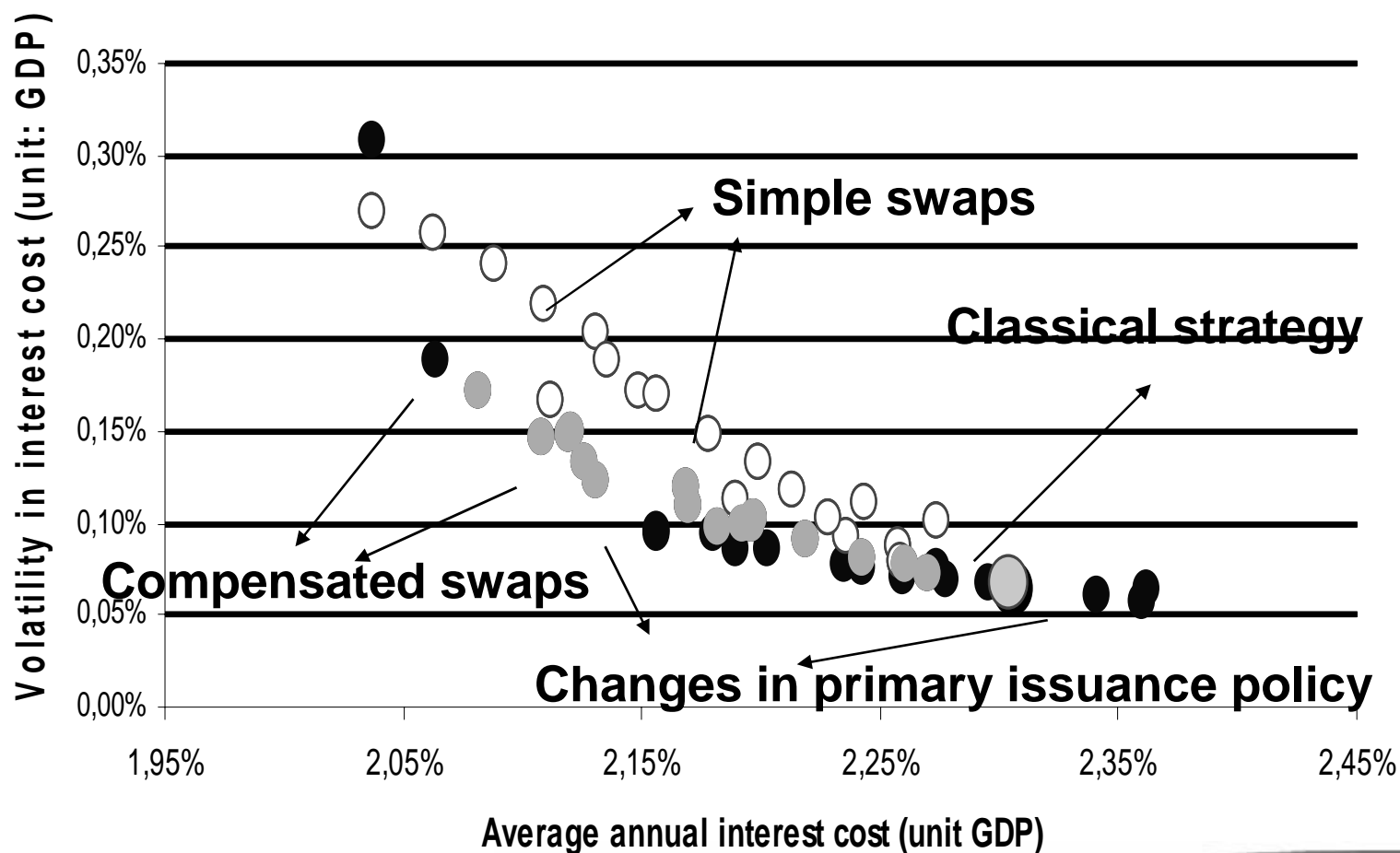
Source: Banque de France

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# A Cautious & One-Dimensional Use of Interest Rate Swaps

- The issuer's interest : reducing duration of debt portfolio helps to achieve a better balance between interest cost and variability
- The markets view : investors demand remains sustained at the long end of the curve ; major issuers must be transparent and predictable and not disruptive
- AFT's approach : a swaps policy based on a long-term view of the yield curve, aimed only at decreasing debt duration, which makes it possible to decouple duration management and primary issuance.

# Managing Interest Risk with a Swaps Portfolio

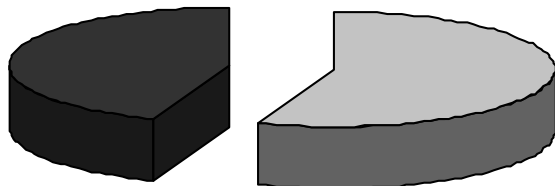


# Meeting Demand & Investing in Market New Developments: The issue of Inflation Linked Bonds

- Optimising the State's Balance Sheet
  - Asset-liability management: Revenues are correlated with inflation, directly or indirectly
  - Budget smoothing: Inflation is negatively correlated with fiscal deficits
  - Diversification of the State's liability portfolio
- Meeting Strong Demand
  - And diversifying the investor base
- Providing a Public Good
  - Expanding the hedging opportunities of private agents
  - Providing policymakers with a market measure of expected inflation
- Is it Cost-Efficient?
  - In an efficient market, inflation is fairly priced and nominal and real bonds are equivalent
  - Additionally, the inflation-risk premium is eliminated

# The French OATi and OAT€i Market

## Foreign Holdings of OATi/€i



**French Residents**  
44.5%

**Non-French Residents**  
55.5%

	2002	2003	2004	2005 Q1 (1st estimation)
OATi	31.9%	31%	37.2%	32.5%
OAT€i	56.3%	64.1%	69.1%	70.3%
OAT	34.2%	39%	40.6%	40.4%
Notes and bonds	41.9%	47.3%	49.1%	48.5%

## AFT Commitments regarding ILBs

- *Regularity & Predictability* : issuance Monthly excl. August and December
- *Relevance*: 10% at least of the issuance programme and significantly more if justified by demand
- *Same organisation of liquidity* through SVT's market making as for the nominals, for the 2 classes of ILBs.
- *Open question*: looking for an optimal share of ILBs in the global debt portfolio

## Face value as of 31 July 2005

French Inflation (OATi): €41.6bn

Euro Area Inflation (OAT€i): €36.1bn

Source: Banque de France

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# More Information on... 适应大众的新网站

[www.aft.gouv.fr](http://www.aft.gouv.fr)

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Reuters:  
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TRESOR  
<GO>

The screenshot shows the Agence France Trésor website. At the top left is the logo for Agence France Trésor, République Française. The main header features a banner with financial data: OAT 6,75%, BTAN 3,75%, and OAT 5,5%. Below the banner is a navigation menu with links for '网站地图' (Site Map) and '联系我们' (Contact Us). The main content area is divided into three columns. The left column contains a sidebar with links to '法国国库署', '预算框架', '国家债务', '国家流动资金', '对风险的控制', '经济指数', '搜索', '国债专营机构专区', '媒体', '出版物', '链接', 'Q & A', and '词汇汇编'. The middle column contains a welcome message: '欢迎进入法国国库署网站。' followed by a description of the agency's mission and a link to '竞标发售时间表'. Below this is a section for '出版物' (Publications) with links to a 'Monthly bulletin n° 183 - August 2005 (PDF, 450.8 ko)' and a '2004/2005 Annual report and 2004 Annual review (PDF, 1.9 Mo)'. The right column contains financial data for '2005年07月31 days' including '债务余额' (865 663 590 834 EUR) and '可转让债务的平均年限' (6 years and 312 days). It also lists '指数计算系数' (Index Calculation Coefficients) for OATI and OAT€I, and '指数' (Indices) for '债务' (Debt) and '现金流' (Cash Flow). At the bottom of the page is the logo for the 'MINISTÈRE DE L'ÉCONOMIE DES FINANCES ET DE L'INDUSTRIE'.