Governance Dimensions of a Public Debt Management Strategy: After Design Comes Approval

Public Debt Strategic Planning Department
Brazilian National Treasury
Ministry of Finance

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In 1986, the National Treasury was created within the Ministry of Finance.

In 1992 the Treasury started to issue bonds regularly through auctions to finance federal government budget deficits (first it had mandate for the domestic debt, but not for the external, which was Central Bank responsibility until 2005).

In 1999, it was implemented a new model for public debt management, informally, as a working group, and in 2001, formally, based on a DMO framework (back, middle e front offices), that put the National Treasury in line with the best international practices.

In 2000, the Fiscal Responsibility Law was approved, establishing that, from 2002 on, the Central Bank could no longer issue bonds in the primary market, conducting monetary policy with bonds issued by the National Treasury.

In 2003, a Public Debt Committee was created to discuss and to make decisions in all the strategic planning steps. The Public Debt Committee is composed by the heads and members of all the three offices and is led by the National Treasury Undersecretary for Public Debt. The committee is responsible for discussing all phases of strategic planning.

In 2003, Decree n. 4343 establishes the National Treasury as the responsible for managing both domestic and external debt. After a transition period, in 2005 the Treasury assumed definitely the responsibility for the whole debt management.
Background

Institutional Advances: Strategic Planning, Transparency and Communication

» In 2000, the first Annual Borrowing Plan was released, aiming at improving the transparency regarding the public debt financing strategy. The Annual Borrowing Plan (ABP) has been published by the National Treasury since then, presenting its objectives, guidelines, strategy and targets related to FPD.

   » More than a planning tool, the ABP has become an instrument to increase debt management transparency and predictability.

» In 2001 it was created an Institutional Relations Unit within the Middle Office: a direct channel with the press, rating agencies and market agents in order to provide information about the public debt.

» In 2003 the first Annual Debt Report was released, aiming at describing the major accomplishments of the last year’s ABP

» In 2003 the National Treasury began studies on the optimal composition, a long term benchmark for the debt structure. The optimal composition targets were first published in the 2011 ABP.

» MTDS (Medium Term Debt Strategy) has been developed since 2005. The transition strategy establish a bridge between short and long term. It seeks to evaluate risks, constraints and opportunities for FPD management over a period of time longer than the current fiscal year. It is not released to the public.
Background

Institutional Advances: Strategic Planning, Transparency and Communication

» The National Treasury has come a long way from transparency to build trust in agents.

» **Simple and robust indicators** are used in the APB and for the long term optimum composition as well as setting targets for these indicators. The ABP set targets for the debt composition and for its maturity structure.

» It is **essential to publicize the goals and responsibilities** of debt management to ensure credibility. Transparency reduced the market uncertainties related to debt management goals and made political decisions more consistent.

» **There are no demands on law concerning mandatory design and publication of financing strategies, ABP or MTDS.**

» Nevertheless, Congress has control elements with respect to the management of public debt

» There are some legal limits to the public indebtedness level in Brazil, constraining the amount of new credit operations in a year, as well as the stock of debt (net and gross)

» Besides, the Budgetary Guidelines Law (LDO) requires an assessment of fiscal risks that may arise from and to public debt.

» A report on debt management is also part of the Annual Presidential Message to the Congress.
Debt Management Strategy

Strategic Planning Process: a long path

BEGINING
No Objective/ No Planning/ No Standards/ No Risk Management

INSTITUTIONAL ARRANGEMENT (~2000)
Planning and Risk Management Transparency/ Communication

STRATEGIC PLANNING (~2000)

DIAGNOSE
(Where we were)

ALM & Traditional Risk Indicators (1st Phase)
“at-risk” indicators (2nd Phase)
Benchmark model (3rd Phase)

OBJECTIVE
(Where we want to be)

DEBT COMMITTEE (2003 - ...)

Short-term strategy and targets

ABP (2001 - …)

Risks, constraints, opportunities

MTDS (2005 - …)

Guidelines (Qualitative Strategy)

BENCHMARK
(Where we want to be)
Debt Management Strategy

Decision Making Process – Debt management committee

Cash Management

Domestic Market

Short term Strategy

Auction

External Market

Debt Committee

Public Debt Under-Secretary

Head of Front-Office

Head of Middle-Office

Head of Back-Office

Risk Management

Technical Staff

MTDS

Benchmark

Targets Monitoring

Benchmark

Medium Term Strategy

Annual Borrowing Plan

Treasury Secretary
Debt Management Strategy

- Fiscal Policy and Budget
  - Fiscal target (primary surplus)
  - Direct issuances
  - Budgetary resources for debt payments

- Public Debt (current stock)
  - Gross Financing Needs:
    - Debt maturing (held by the public)
    - Interest due to the Central Bank
  - Monetary and FX policies
    - Net issuances required to mop up liquidity
    - Foreign reserves

- Government Net Financing Needs

- Objectives and Guidelines of the Public Debt Management

- Public Debt Strategic planning
  - Borrowing plan (issuances by financing instruments)
  - Debt indicators path (stock, index composition, maturity profile, cost and risk)

- DEBT MANAGEMENT COMMITTEE

- TREASURY SECRETARIAT AND MINISTRY OF FINANCE

- Financial and Macroeconomic scenarios

- Tactical planning, monitoring and execution
  (Front Office)

(Fiscal Authority – Treasury) (Middle Office) (Back Office)
Annual Borrowing Plan

Coordinating Public Debt Management with Fiscal and Monetary Policies

» Fiscal Policy

» The Annual Borrowing Plan – ABP presents a forecast of budget resources allocated to payments of federal government debt. Though distinct, this amount bears a correlation to expectations of the public sector primary surplus target defined in the Budget Guidelines Law.

» Fiscal policymakers also provide expectation on direct issuances as well contingent liabilities for the current year, which affect the ABP targets.

» Monetary Policy:

» In Brazil, the Fiscal Responsibility Law (LRF), approved in 2000, prohibits Central Bank to issue its own bonds. The CB uses National Treasury bonds in its portfolio to conduct monetary policy.

» In preparing the APB, the National Treasury evaluates the liquidity in the economy and, if financing conditions permit, uses to conduct net issuances to support liquidity control.
Annual Borrowing Plan

**Decision Making Process and Approval**

» The development of the Annual Borrowing Plan begins in October and is expected to end at the beginning of January of the following year.

» The strategy and targets are discussed and approved by the Debt Committee. The final approval is done by the Treasury Secretary. After, a document is written to details the strategy, starting with two letters, one from the Minister of Finance and the other from the Treasury Secretary.

» The middle-office is responsible for the ABP technical coordination and the front-office for its tactical planning.

» Since the first ABP release, in 2001, only once, due to the 2008 crises, it was necessary a revision of its targets. In order to maintain transparency in debt management, the new targets were released to the public as soon the committee perceived that the original ones could not be achieved.

» A recent advance that occurred in the last ABP was the release of an annual calendar of auctions.
Debt Management Strategy

**Decision Making Process – Schedule of the planning process**

<table>
<thead>
<tr>
<th>Process</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
<th>Jan</th>
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<tbody>
<tr>
<td>Benchmark studies</td>
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<td>MTDS - 5 years plan</td>
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<tr>
<td>ABP elaboration</td>
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<tr>
<td>ABP revisions*</td>
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</tbody>
</table>

* Monthly meetings of debt management committee
** Full revision of ABP at least twice a year (April and August)

- Each step in the process of debt planning is submitted to the Debt Management Committee to discussion and approval.
Debt Management Strategy publication and dissemination

Commitment to Transparency

» Main Publications:

  » The Annual Public Debt Borrowing Plan, since January 2000, which presents the National Treasury’s objectives, guidelines, financing needs, strategies and targets to the end of the year;

  » The Annual Debt Report, which offers a retrospective analysis of PDM for previous year, describing the goals and targets, and its results.

  » The Monthly Debt Report, which presents information and statistics on issuances, buybacks, outstanding debt and its average maturity and life, maturity profiles and average costs for the FPD, including domestic and external federal debt, for which the Treasury is responsible.

  » The Yearly Issuance calendar, which, at the start of each year, list the dates of auctions, as well the types of bonds to be offered in each auction.

» Transparency itself is a powerful enforcement mechanism to allow the DMO to implement debt strategies according to its preferences and analytical work
Lessons Learned on governance dimensions of debt management strategy

**Transparency as a Guideline**

- Debt management requires a well defined (long term) objective and clear guidelines
- Transparency itself is a powerful enforcement mechanism to allow the DMO to implement debt strategies according to its preferences and analytical work
- The definition of targets involves balancing transparency and flexibility to react to shifting in market conditions, without shifting the long term goal
- Institutional aspects are important to support strategy design and dissemination
- The Annual Calendar of Auctions was released for the first time this year, reflecting the maturity of our market and the previsibility of our practices. However, the disclosure of detailed information on the supply size and tenures are still challenging:
  - Depend on the local market stability
    - Steady investor’s base
    - Deepness and price dissemination
ANNEXES
Debt Management Strategy

Objectives and Guidelines

The objective of the Federal Public Debt Management is that of efficiently meeting the National Treasury Borrowing Requirements, at the lowest possible long-term financing costs, while ensuring the maintenance of prudent risk levels. Additionally, the aim is to contribute to the smooth operation of the Brazilian government securities market.

To achieve this objective, the guidelines underlying FPD management are as follows:

- Increase the average maturity of the outstanding debt
- Smooth the maturity profile, with special attention given to short-term maturities
- Gradual replacement of floating-rate securities by fixed-rate and inflation-linked instruments
- Improvement of the External Federal Public Debt (EFPD) profile through issuance of benchmark securities, buyback program and structured operations
- Development of the yield curve on both domestic and external markets and growth in the liquidity of federal government securities on the secondary market
- Broadening of the investor base
## Annual Borrowing Plan – Main Information Disclosed

**Benchmark - Optimal Composition Provides Quantitative Guidelines**

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Long Term Limits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profile - %</strong></td>
<td></td>
</tr>
<tr>
<td>Fixed Rate</td>
<td>45</td>
</tr>
<tr>
<td>Inflation Linked</td>
<td>35</td>
</tr>
<tr>
<td>Floating Rate</td>
<td>15</td>
</tr>
<tr>
<td>Exchange Rate</td>
<td>5</td>
</tr>
<tr>
<td><strong>Maturity Structure</strong></td>
<td></td>
</tr>
<tr>
<td>% Maturing in 12 months</td>
<td>20</td>
</tr>
<tr>
<td>Average Maturity</td>
<td>5.5 years</td>
</tr>
</tbody>
</table>

» In its first release, in 2011 Annual Borrowing Plan, only composition targets were published. The maturity objectives were disclosed latter (2012 and 2013 ABP).
Annual Borrowing Plan – Main Information Disclosed

**Borrowing Requirements**

- **Gross Borrowing Requirements**: R$ 543.8 bn
- **Budget Resources**: R$ 131.2 bn
- **Net Borrowing Requirements**: R$ 412.6 bn

- **External Debt**: R$ 10.7 bn
- **Domestic Debt Held by the Public**: R$ 493.2 bn
- **Interest due to Central Bank**: R$ 39.9 bn
### Benchmark Securities to be Offered in the Current Year

<table>
<thead>
<tr>
<th>Yield</th>
<th>Bond</th>
<th>Benchmark</th>
<th>Maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed rate</td>
<td>LTN</td>
<td>Short and Medium-Term</td>
<td>January, April, July and October</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Up to 4 years (4 vertices)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>NTN-F</td>
<td>Long-term</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Between 5 and 10 years (2 vertices)</td>
<td>January</td>
</tr>
<tr>
<td>Floating rate</td>
<td>LFT</td>
<td>Maturity greater than average for FPD</td>
<td>March and September</td>
</tr>
<tr>
<td>Price indices</td>
<td>NTN-B</td>
<td>Group I – Short and Medium-Term / Up to 10 years (2 vertices)</td>
<td>May and August</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Group II – Long-Term</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>20, 30 and 40 years (3 vertices)</td>
<td></td>
</tr>
</tbody>
</table>

At its discretion, the National Treasury may hold off-the-run securities auctions with the objective of correcting possible distortions in government bond prices.
### Annual Borrowing Plan – Main Information Disclosed

#### Frequency of Public Auctions Along the Year

<table>
<thead>
<tr>
<th>Bond</th>
<th>Periodicity</th>
<th>Traditional</th>
<th>Exchange</th>
<th>Buyback</th>
</tr>
</thead>
<tbody>
<tr>
<td>LTN</td>
<td>Weekly</td>
<td>Best Price</td>
<td>Half-yearly</td>
<td>Best Price</td>
</tr>
<tr>
<td>NTN-F</td>
<td>Fortnightly</td>
<td>Best Price</td>
<td>Monthly</td>
<td>Best Price</td>
</tr>
<tr>
<td>LFT</td>
<td>Monthly</td>
<td>Best Price</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NTN-B</td>
<td>Fortnightly</td>
<td>Uniform</td>
<td>Monthly</td>
<td>Best Price</td>
</tr>
</tbody>
</table>

1. Criterion for selecting proposals in the auctions: In the uniform criterion, all proposals with quotes equal to or greater than the minimum quote will be accepted. This will be applied to all winning proposals. In the best price criterion, the proposals accepted pay the price presented in the bid.
Annual Borrowing Plan – Main Information Disclosed

Main Targets to the End of the Year

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2012</th>
<th>Limits for 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Minimum</td>
<td>Maximum</td>
</tr>
<tr>
<td>Stock (R$ billion)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FPD</td>
<td>2.008,0</td>
<td>2.100,0</td>
</tr>
<tr>
<td>Profile (%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Rate</td>
<td>40,0</td>
<td>41,0</td>
</tr>
<tr>
<td>Inflation Linked</td>
<td>33,9</td>
<td>34,0</td>
</tr>
<tr>
<td>Floating Rate</td>
<td>21,7</td>
<td>14,0</td>
</tr>
<tr>
<td>Exchange Rate</td>
<td>4,4</td>
<td>3,0</td>
</tr>
<tr>
<td>Maturity Structure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>% Maturing in 12 months</td>
<td>24,4</td>
<td>21,0</td>
</tr>
<tr>
<td>Average Maturity (years)</td>
<td>4,0</td>
<td>4,1</td>
</tr>
<tr>
<td>Average Life (years)</td>
<td>6,4</td>
<td>_</td>
</tr>
</tbody>
</table>

» The choice of presenting the targets in terms of limits gives some flexibility to the debt manager without losing the previsibility stance that should guide the financing strategy. This element is especially important in countries with no long economic stability record.
Annual Borrowing Plan

Last Decade Results

Fixed Rate

Inflation Linked

Floating Rate

Exchange Rate
Annual Borrowing Plan

Last Decade Results

% in 12 Months

Average Maturity

% of FPD

Years

Range Min/Max

Range Min/Max
For additional information access the National Treasury website:

www.tesouro.fazenda.gov.br

Or contact Institutional Relations area:

brazildebt@fazenda.gov.br

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