Policy dialogue

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Managing contingent liabilities

Programme

7 – 8 December 2016
Pretoria, South Africa

Contingent liabilities pose an increasing risk of destabilising a government's public finances. As ministries of finance develop their public debt management capabilities, an important consideration is the role of the middle office in managing contingent risks. This policy dialogue aims to provide risk managers with an opportunity to share their experiences on challenges they have faced, the lessons they have learnt and the good practices they are striving to implement. The programme is structured around the following five aspects of contingent liability management: (i) understanding the costs; (ii) establishing a robust regulatory and policy framework; (iii) building an enabling institutional environment; (iv) improving measurement of CLs; (v) proactively managing the application, assessment, approval, recording and monitoring processes; and (vi) instituting comprehensive disclosure and reporting requirements.

Wednesday 7 December 2016	
08:00 – 09:15	**Arrival and registration**
09:15 – 09:30	**Welcome**
Session 1 09:30 – 11:00	**Panel discussion on understanding the risks of contingent liabilities** A panel discussion between representatives from an African ministry of finance, leading experts and a fund manager. **Objective:** To discuss (i) why the fiscal risk associated with contingent liabilities has increased in recent years; (ii) the implications of not fully understanding the costs and not proactively managing the risks; and (iii) trends that are emerging globally and regionally. **Panel:** Lloyd Ramakobya *(National Treasury of South Africa)*, Adré Smit *(Association for Savings and Investment South Africa)*, Fatos Koc *(OECD)*, Mampho Modise *(National Treasury of South Africa)* and Tiviniton Makuve *(MEFMI)* **Moderator:** Neil Cole *(CABRI)*
11:00 – 11:30	*Tea break and group photo*
Session 2 11:30 – 13:00	**Regulation of contingent liabilities** In most countries, the public finance management act prescribes the powers of government and public entities to borrow money and issue guarantees, indemnities and securities. The coverage and content of countries' contingent liabilities' regulatory frameworks, the policy guidelines which support them and the degree of implementation may differ. **Objective:** To understand countries' existing legal coverage, progress with implementing policy frameworks and the challenges that have impeded progress.

	Countries will share insights into how these challenges have or can be addressed. This will allow for development of more robust regulatory frameworks which ensure that stakeholders abide by contingent liabilities limits and good practices. Presentation on the implications of the contingent liability legal and policy framework by Thandeka Ncala *(Directorate of Corporate Law, National Treasury of South Africa) (15 mins)* Presentation on OECD countries' regulatory frameworks by Fatos Koc *(OECD) (15 mins)* Discussion *(1 hr)* **Facilitator:** Mkhulu Maseko *(National Treasury of South Africa)*
13:00 – 14:10	*Lunch and energiser*
Session 3 14:10 – 15:40	**Institutional arrangements to facilitate coordination** Clarity in the structure, mandate and roles and responsibilities of the institutions involved in contingent liabilities management strengthens coordination within the ministry of finance. Strong institutions also improve relations with stakeholders outside of the ministry who may have divergent interests. This ensures that decision-makers understand the potential risk of contingent liabilities and are encouraged to limit their realisation. **Objective**: To review the differing institutional arrangements of the countries present and to consider how to effectively bring about coordination that allows for collective and informed decision-making. Presentations by Mali, Botswana and Egypt *(5-7 mins each)* Presentation on the role of state-owned entities by Philip Gildenhuys *(SANRAL) (15 mins)* Discussion *(1 hr)* **Facilitator:** Tiviniton Makuve *(MEFMI)*
15:40-16:00	*Tea and coffee*
Session 4 16:00-17:00	**Improving comparability and predictability through measurement** Measurement of contingent liabilities is a prerequisite for transparency and good governance. If potential liabilities are not properly priced and evaluated, they cannot be controlled or managed. Despite its importance, measurement is often neglected within countries' fiscal risk assessments. **Objective:** To discuss the tools of and approaches to measuring contingent liabilities. Presentation on measurement tools and approaches *(15 mins)* Discussion *(45 mins)* **Facilitator:** Fatos Koc *(OECD)*

Thursday 8 December 2016	
9:00-9:15	**Key messages from day one**
Session 5 9:15-10:45	**The five steps of contingent liabilities management** Managing contingent liabilities is a complex task as it encompasses a number of steps, responsibility for which falls under different departments. These steps include application, assessment, approval, recording and monitoring. **Objective**: To gain an understanding of how processes and risk assessment tools differ between countries, how formal processes become common practice, what the challenges are and how they can be addressed. Presentation on the DMO's role in contingent liabilities management by Lerzan Ülgentürk *(Treasury of Turkey) (15 mins)* Presentation on risk assessment tools by Mkhulu Maseko *(National Treasury of South Africa) (15 mins)* Open discussion *(1 hr)* **Facilitator:** Mampho Modise *(National Treasury of South Africa)*
10:45-11:15	*Tea and coffee*
Session 6 11:15-13:00	**Application, assessment and approval in practice** What do SOEs include or exclude from their applications? What considerations are important for the guarantee approval committee? **Objective**: To increase insight into the nuances, agendas and challenges within the application and approval processes. Roleplay exercise *(1 hr 15 mins)* Feedback *(30 mins)* **Facilitator:** Johan Krynauw *(CABRI)*
13:00 -14:00	*Lunch*
Session 7 14:00-15:30	**Disclosure of and reporting on contingent liabilities** Disclosure implies that information on contingent liabilities is provided by the accountant general and government departments through financial statements and by the minister of finance during the annual budget. Reporting on this information allows the risk manager to manage the country's risk exposure from contingent liabilities. Dissemination of this information, when accurate, increases budget credibility and allows for enhanced oversight. **Objective**: To compare current practices in disclosure and reporting mechanisms, and to promote good practice. Perspectives from Department of Public Enterprises, African Organisation of English-speaking Supreme Audit Institutions (AFROSAI-E), and National Treasury of South Africa **Facilitator:** Lerzan Ülgentürk *(Treasury of Turkey)*
15:30-16:00	*Tea and coffee break*

16:00 – 17:00	**Summary and closing session** This session will begin with a recap of the key messages from day two. The delegates will share their key takeaways. Finally, delegates will note the areas in which they would like further support from CABRI. **Facilitator:** Neil Cole *(CABRI)*

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Preparatory questions

The questions below, relating to the sessions of the programme, will assist participants in their preparation and facilitate informed discussion during the policy dialogue.

Session 2: Regulation of contingent liabilities

1. Which act in your country prescribes the powers of government and public entities to borrow money and issue guarantees?
2. Which person or entities, according to the act, may enter into a transaction, borrow or issue a guarantee? Does this act binds the revenue fund from any further financial commitment in terms of guarantees?
3. What are the responsibilities of relevant cabinet ministers when issuing guarantees or considering issuing guarantees, as well as the duties of the ministers in terms of the law?
4. What is the role of the minister of finance in the issuance of guarantees?
5. Are there any restrictions on the state to grant guarantees entered into by a state agency? These may include: payment obligations to individuals; titles assured/guaranteed by the state; payment obligations or guarantees to state agencies not in good standing; a warranties extended to contract operations already contracted, if the original commitment was without a warranty or guarantee.
6. Are there any preconditions, such as limits on the amount guaranteed that a guarantor may impose prior to the issuance of a guarantee?
7. An act is only effective if it is adhered to and if there is proper recourse. What is the experience in your country?
8. From a legal perspective – what does the issuance of a guarantee imply?
9. Does the legislation prescribe how contingent liabilities are to be managed? This may include requirements for assessment and reporting of contingent liabilities.
10. If so, does the legislation prescribe who is responsible for the management of contingent liabilities?

Session 3: Institutional arrangements to facilitate coordination

A well-designed framework for managing and monitoring contingent liabilities, imposes proper safeguards against risks associated with contingent liabilities and is critical in limiting the government's risks exposure.

1. Describe the current structure of contingent liability management in your country, including the co-ordination between, mandate and roles and responsibilities of the institutions.
2. Are there any existing processes or interaction amongst the institutions with the purpose of limiting or avoiding the potential risks from being realised?
3. What is your setup in terms of the entity responsible for monitoring and managing contingent liabilities – is it situated within a central place/ministry?
4. Within the ministry of finance, which entities or divisions are best placed for monitoring? If no entity is currently monitoring, who should be involved and what would their roles be? Is it the role of the macro-fiscal department or the credit risk unit within the public debt office DMO)? (Some countries have integrated the management of contingent liabilities within the DMO (Colombia, Morocco and Sweden). Others manage the government debt portfolio within an asset and liability framework (ALM), such as South Africa and New Zealand. In others countries, such as Ireland, Poland and Portugal, contingent liabilities management is

located outside the DMO, usually within the ministry of finance. Which framework is applicable to your country and why was it chosen?

5. It may not be feasible to manage PPPs within the DMO as PPPs require specialised expertise to assess projects or sector-specific guaranteed programmes. Contingent liabilities arising from the PPPs might, however, pose large fiscal risks for the government that the DMO/Ministry of Finance should be aware of and monitor. What are your country arrangements with regard to managing PPPs? Does the DMO/Ministry of Finance in your country have access to information on PPP commitments and does it have any monitoring role?
6. In countries where decentralised public financial management systems exist, line ministries are allowed to issue contingent liabilities, as long as they have adequate financial capacity to do so (which is usually the case in developed countries). In such cases, internal audit units of the ministries play an important role in controlling and overseeing the management of risks associated with contingent liabilities. In countries where the public financial management system or the capacity outside the ministry of finance is weak, there is a strong need for a centralised approach to collating, analysing and disclosing fiscal risks. Is this a fair assumption or what could be the strengths and weaknesses of the different approaches mentioned?
7. Do the decision makers in your country understand the potential risks related to contingent liabilities? What role does parliament play in the issuance of guarantees, if any?
8. Mitigating contingent liability-related risk requires that policy makers understand the nature of the risk involved and address them before entering into transactions that result in contingent liabilities. This is best achieved by putting in place a comprehensive framework that guides policymakers in assessing the need to enter into contingent liabilities. The framework should also address the costs and benefits in issuing contingent liabilities and also the departmental arrangements for the valuation/measurement of the costs at the stage of appraisal. Do you have such a framework ensuring informed CL decisions by the policy makers?
9. Is there any formal structure or committee in place who will receive, analyse, discuss and debate a new guarantee application and make recommendations to the minister or parliament?
10. If this structure exists, who (members) are present on the committee and why have they been chosen?
11. Are there terms of reference that underpin the functions, mandate and responsibilities of the committee? (Please bring along a copy of the terms of reference for discussion at the dialogue).
12. How regularly do the members of the committee meet?

Session 5: The five steps of contingent liabilities management

These steps are application, assessment, approval, recording and monitoring of a new request for a guarantee.

1. Explain the process in your country that an applicant will undertake prior to submitting an application for a guarantee.
2. When an application is received, who (unit) is responsible for analysing the application prior to its submission to the committee for recommendation?

3. In the assessment of the new application, what risk rating methodology are you using and why e.g. business and financial risks indicators?
4. Explain your assessment or evaluation processes and how the risk rating for each application is determined.
5. Is the institution or person responsible for approving guarantees allowed to set conditions attached to the application. What could those conditions be and for what purpose?
6. Do you apply fees for the guarantees issued? If yes, is it a flat fee applied on the nominal guaranteed amount or do you calculate fees for each application based on the cost analysis of the transaction?
7. If the minister approves the request, what is the process that is followed to inform the applicant of the outcome of the application?
8. Are you keeping a central register of all approved guarantees?
9. Is the information on guarantees in the register subject to verification and audit processes?
10. What process is followed to obtain information on guarantees and the utilisation thereof following the initial application and approval process?
11. Describe the monitoring process of the entities to which guarantees were submitted and the continuous interaction to avoid the possibility of the realisation of the guarantee?
12. Does the entity responsible for managing contingent liabilities use credit risk assessment tools such as guarantee fees, collateral, contingent reserves accounts?
13. Risk management of the portfolio of the contingent liabilities already issued is a crucial exercise which involves the application of some risk management/mitigation tools at the portfolio level, including setting up a contingency reserve fund, applying ceilings and budgetary provisioning. Do you apply any risk mitigation tools in your country?

Session 7: Disclosure and reporting of contingent liabilities

There are two main internationally-recognised accounting standards: one for private sector companies called International Financial Reporting Standards (IFRS) and one for the public sector, developed on the basis of IFRS, called International Public Sector Accounting Standards (IPSAS).

According to IFRS, contingent liabilities are not recognised, but rather disclosed as part of the notes to the financial statements. They are then recorded as provisions if they materialise. Under current statistical reporting standards of the IMF and the European Union, contingent liabilities are not considered as liabilities unless they materialise. Progress has been made towards harmonising the statistical and accounting standards, including their treatment of contingent liabilities. The OECD is currently taking on the work of harmonising the two standards.

In the interim, what is good practice on disclosure of and reporting on contingent liabilities?

1. Do you treat contingent liabilities, depending on the type, differently in your country from statistical and accounting perspectives?
2. Is there a difference in disclosure and reporting of those contingent liabilities that are already recognised (called ‘provisions’) and those that have not been recognised in the financial statements, either because the contingency is not likely to materialise (probability is less than 50 per cent) or the payments cannot be estimated reasonably well?
3. When guarantees are approved, they should be recorded, therefore accounted and disclosed for in the financial statements?

4. The question is then, should the contingent liability be reported on fair value or present value or when should fair value and when should present value or both be used? (Calculating fair or present value entails the calculation of expected cost based on the default probability of the occurrence of the contingency).
5. Do you follow the IMF standards on reporting on and disclosing contingent liabilities?
6. In terms of government departments, what are the current practices with regard to reporting of and disclosing contingent liabilities?
7. What role does parliament play in the reporting and disclosure of contingent liabilities?
8. Are these reporting and disclosure practices stipulated by law?
9. Is data or the collection of data on contingent liabilities a problem and why?
10. What is the role of the accountant general in your country on reporting and disclosing contingent liabilities?
11. With regard to information on contingent liabilities and the risks associated with contingent liabilities, is the information shared with senior management or ministers?