WORKSHOP ON ASSET AND LIABILITY MANAGEMENT

South African Experience and Lessons learnt in implementing prudent debt and risk management strategies

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REPUBLIC OF SOUTH AFRICA

Overview of the presentation

- South African Domestic Markets prior to 1990
- Market Developments 1990 until 1998
- Evolving Debt Management Strategies from 1999 until 2002
- Developments post 2002 until 2008
- Developments Post the Financial Crisis - 2008
- Conclusion

South African Domestic Markets Prior to 1990

History of South Africa Debt Capital Market –

- No formal or prevailing market rate existed
- Government periodically issued bonds at par
- Several investigations and reports on development of Debt Capital Markets in South Africa – consensus among market participants
- Eskom first public entity to issue bond at discount
- No clear separation of between monetary and fiscal policies
- Main concern - the Act on Prescribed Assets

South African Domestic Markets prior to 1990

- When prescribed assets lifted, the scene was set to further develop Debt Capital Market in South Africa

- 1989 – Consolidation programme – smaller issuances consolidated into bench mark bonds

- Created bench marked bonds in the 5-year, 10-year, 15-year and 20-year maturities

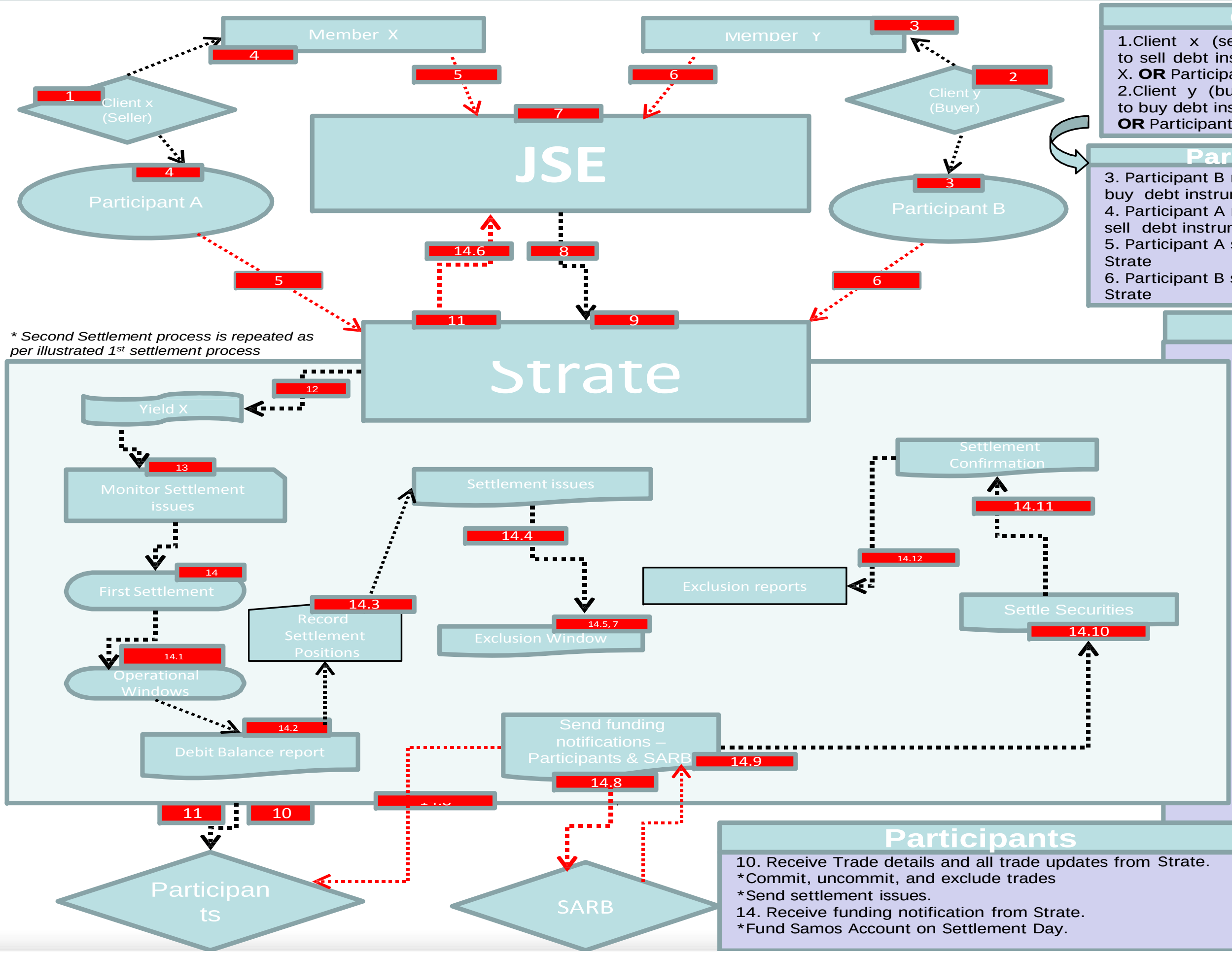
Market Developments 1990 until 1998

Development of Bond Exchange of South Africa –

- Bond Trading Firms forms Market Association, which was formally licensed in 1996 as a formal Exchange – BESA
- Adopted Group of 30 recommendations on clearing and settlements
- UNEXcor established as clearing and settlement, Central Depository house for Bonds - today operates under STRATE
- Exchange members access to – electronic reporting, matching and settlements

Deal Matching and Settlement

Bonds process flow



Clients

1.Client x (seller) sends instruction to sell debt instruments to Member X. **OR** Participant A.
2.Client y (buyer) sends instruction to buy debt instruments to Member Y **OR** Participant B

Members

3.Member Y receives instruction to buy debt instruments from Client y.
4. Member X receives instruction to sell debt instruments from Client X.
5.Member X sends Trade details to JSE
6.Memeber Y sends Trade details to JSE

Participant

3. Participant B receives instruction to buy debt instruments from Client y
4. Participant A receives instruction to sell debt instruments from Client X
5. Participant A sends trade details to Strate
6. Participant B sends trade details to Strate

BESA

7. JSE Receives trade details from member(s).
8. JSE sends trade details to Strate

Strate

9.Receives Trades details from JSE or Participants.
(Trade details are in a form of a swift message).
10.Sends Trades details to participants concerned.
11.Sends all trade updates to Participants and JSE.
(Trade updates are in a form of a swift message).
12. Monitor Yield X trades on S-2.
13 Monitor settlement issues on S-1.
14 First Settlement
14.1 Check operational windows.
14.2 Check and action debit balance report.
14.3 Check and record settlement positions.
14.4 Send settlement issues to Supervision.
14.5 Open exclusion windows.
14.6 Notify JSE once all positions are committed.
14.7 Close exclusion windows.
14.8 Send funding messages to Participants and SARB,
14.9 Receive Payment confirmation from SARB.
14.10 Settle Securities.
14.11 Notify Bonds Market once settlement is completed.
14.12 Send exclusion reports and resolutions to Strate-Supervision.
15 **Second Settlement**
15.1 Check and action debit balance report.
15.2 Check settlement positions and advise participants
15.3 Send funding messages to Participants and SARB.
15.4 Receive Payment confirmation from SARB.
15.5 Settle Securities.
15.6 Notify Bonds Market once settlement is completed.
15.7 Check and Action Debit balance after settlement.

Participants

10. Receive Trade details and all trade updates from Strate.
*Commit, uncommit, and exclude trades
*Send settlement issues.
14. Receive funding notification from Strate.
*Fund Samos Account on Settlement Day.

SARB

14. Receive funding notification from Strate.
*Transfer funds from one participant's account to the other.
*Settlement of funds takes place once all participants have funded.
*Send payment confirmation to Strate.

Market Developments 1990 until 1998

Introducing of bond auctions and market making -

- Early 1990s SARB appointed as agent for issuing, settlement and market making in Gov. Bonds
- Survey conducted in 1996 on how to improve issuances and secondary market-making activities
- Regular auctions introduced
- To ensure efficiency, liquidity and transparency – Primary Dealers appointed (6 foreign and 6 local Banks) in 1998

Market Developments 1990 until 1998

Auctions –

- SARB role changed to only conducting auctions and settlement processes
- Auction calendar introduced – Annual publication of weekly auctions
- Auction of fixed rate bonds only open to Primary Dealers
- Other auctions open to all market participants

Market Developments 1990 until 1998

Primary Dealers –

Structural improvements –

- Creation of efficient legal framework
- Market surveillance of PDs by SARB and National Treasury (NT)
- Introductions by minimum capital requirements of Banks
- Introduction of an auction system to sell and market making Gov. Bonds
- Dematerialization of bond certificates
- Shortening of settlement period – T+3
- Introduction of risks management system in NT

Market Developments 1990 until 1998

Primary Dealers

Liquidity enhancements –

- Continuous provision of market-related bid and offer prices in appropriate volumes and under all market conditions

- Introducing benchmarked bonds and establishment of a repo market

Market Developments 1990 until 1998

The framework of philosophies and principles –

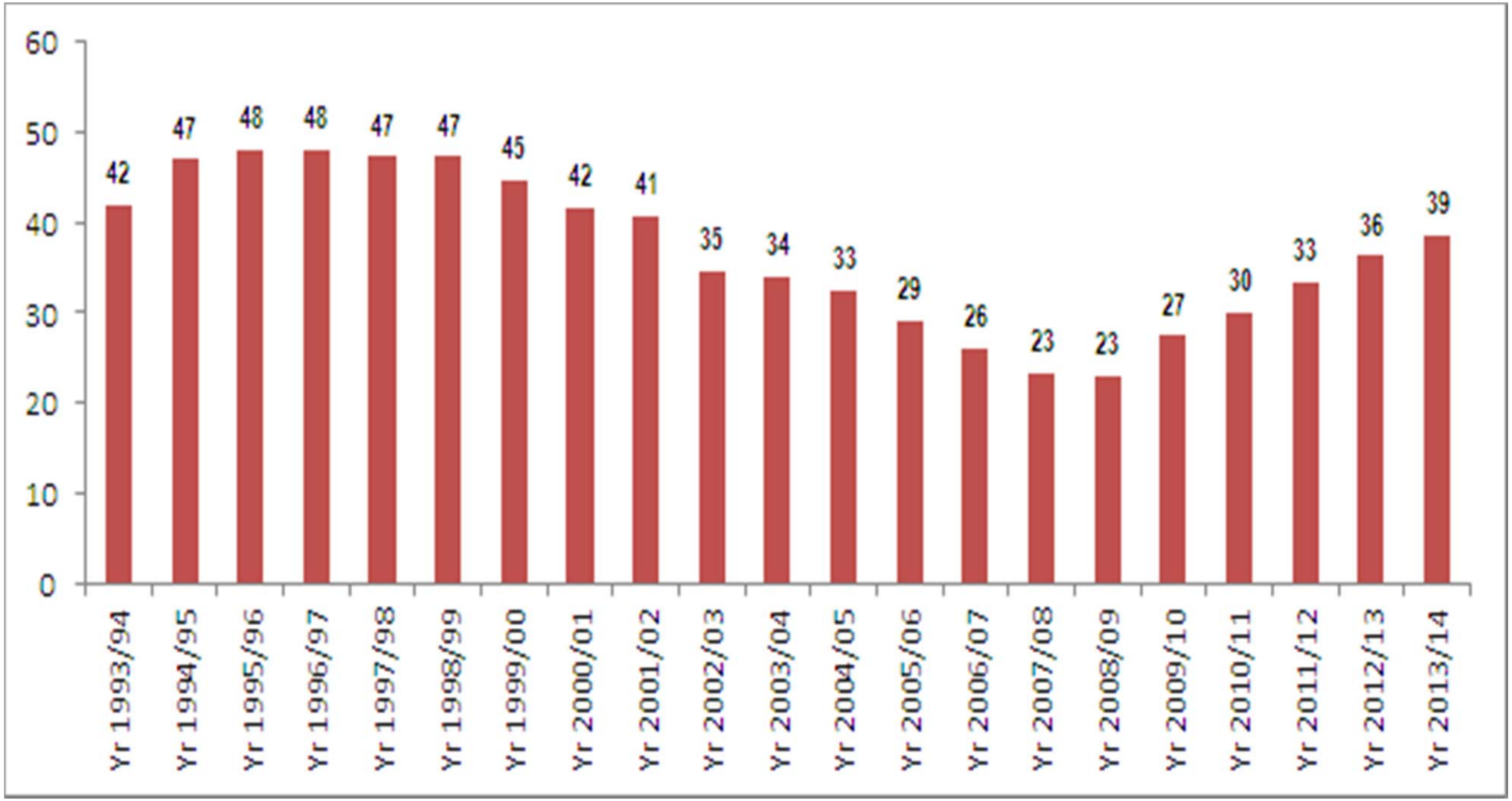
- Early and mid-1990s – an ever increasing budget deficit, rising stock of debt levels, rising debt servicing costs, high interest rate environment, maturity structure only up to 10 years

- Triggered focus on prudent debt management strategies

- Announce in Budget Review of 1996 that entire debt management policies to be reviewed

- Philosophies and principles framework to manage public debt, cash and risks introduced and approved by Parliament

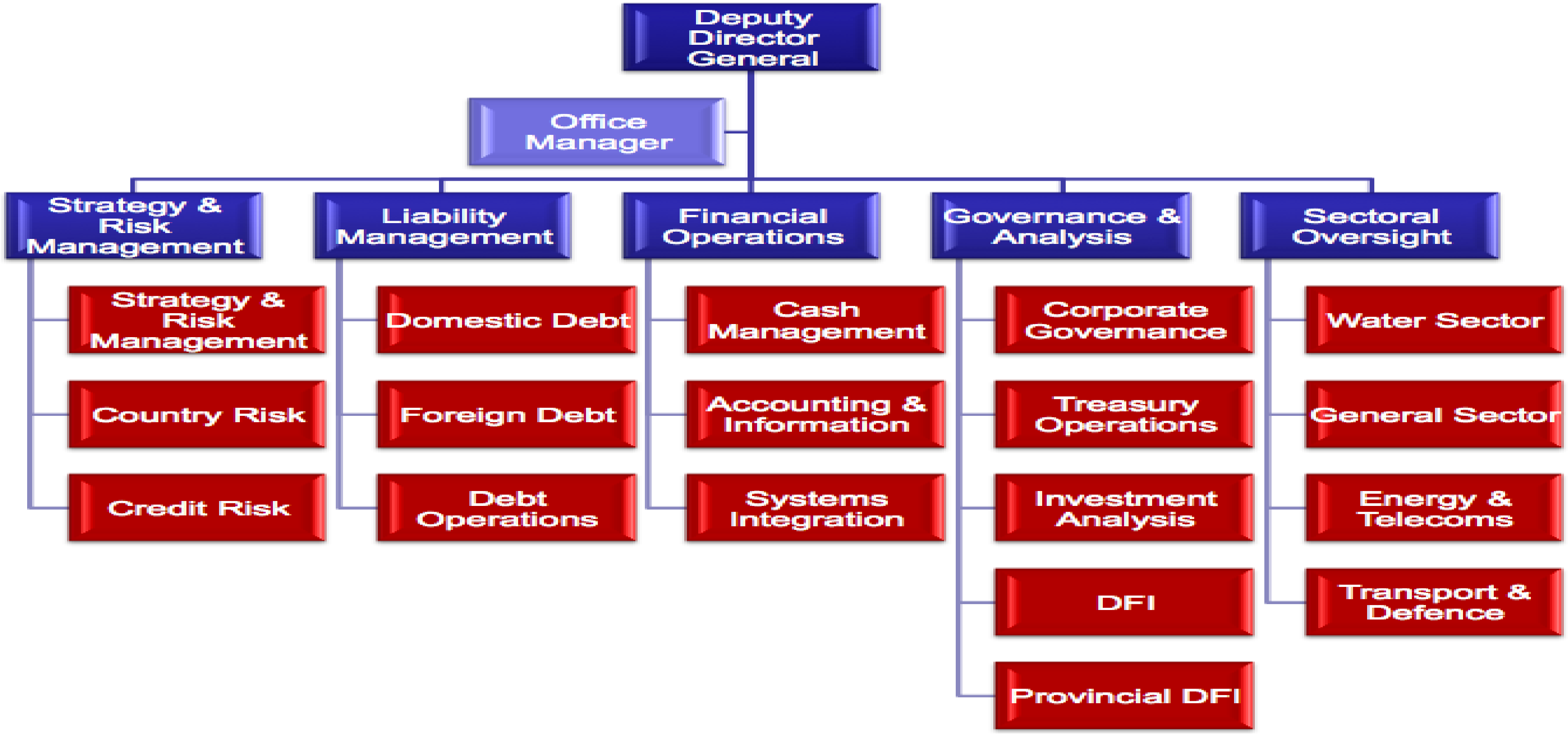
RSA GOV. DEBT AS % OF GDP



Market Developments 1990 until 1998

The framework of philosophies and principles –

- Establishment of the Asset and Liability Management Division within the National Treasury



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Evolving Debt Management Strategies from 1999 until 2002

- 1997-1998 Asian crisis proved that SA Government Market no more at nascent stage

- New challenges – investors willingness to commit at the longer end of the curve and active foreign investor participation lead to change of debt management approach

- Comprehensive Debt Management Framework developed to address policy gaps

Evolving Debt Management Strategies from 1999 until 2002

Identify policy gaps and use of new instruments –

- Introduction of Inflation Linked Bonds and Vanilla bonds with lower coupons
- Proper coordination of funding activities with State-owned Entities
- Coordination of liability management and monetary policy – high level discussions between policy makers
- Shift from strategic to tactical debt management (switches and buy backs)

Evolving Debt Management Strategies from 1999 until 2002

Foreign borrowing –

- Went through a period of restricted access to other markets
- Integrated strategy followed when entering foreign capital markets
- Prime focus not on funding, but to create benchmarks in international markets
- At a time when the total budget deficit could be funded in the domestic market
- Strategy to exploit pricing anomalies to obtain cost-effective funding

Evolving Debt Management Strategies from 1999 until 2002

Risk Management responsibilities –

- Create and maintain a risk management framework for general government, sub nationals and public debt enterprises
- Develop an ideal bench mark for government debt
- Monitor and manage Credit risks, Country and Market risks
- Due to evolve debt management practices and emphasis on advanced tactical and quantitative models rather than policies
- Policies and procedures to control and manage risks exposures in debt portfolio

Evolving Debt Management Strategies from 1999 until 2002

Management and Type of Risks –

- Liquidity, refinancing, interest rate, Currency, Budget, Credit, Downgrade and Operational Risks
- Benchmark approved – reflect and established an acceptable level of risks and target of costs
- Alignment of debt policy to economic policy
- Bench mark provides appropriate risks management, controls and forms a baseline for measuring the performance of debt managers

Evolving Debt Management Strategies from 1999 until 2002

Cash Management –

- Responsibility to plan and manage the government's daily cash-flow was officially taken over from the SARB in June 1999

- Manage liquidity by ensuring the right amount of funds are available in the right currencies, at the right time and the right place

- Plot projected flows and monitor the actual flows against expenditure projections

- Create appropriate organizational structure

- Engineer the required linkages between tax and loan accounts, paymaster general accounts and departmental accounting system

Developments post 2002 until 2008

Declining borrowing requirement -

- As result of sound economic policies, prudent debt management, supported by increasing revenue collection by SARS due to strong growth – South Africa borrowing requirement decline during the period 2002 and 2008

- Country's international credit ratings improved, enabling government to borrow at more competitive rates

- Challenge to uphold efficiency, transparency and liquidity in Bond Market amidst declining borrowing needs

- Achieve through continuous borrowing programme and active debt management strategies, which reduce debt servicing costs

Developments post 2002 until 2008

Diversify funding instrument –

- To diversify government's debt portfolio – inflation-linked bonds introduced and a facility to strip government bonds established

- RSA Retail Savings Bonds launched in 2004 to encourage savings and enable individuals to access secure assets and earn bond market related interest rates

- Government decided to increase South Africa's foreign reserves – rating agencies highlighted that reserve levels low compared to our peers

- Higher reserves protect or cushion against possible external vulnerability and financial uncertainty

Developments post the Financial Crisis, 2008

Macro economic focus -

- Government allowed budget deficit to increase as revenue declined
- Countercyclical fiscal policy and support the economy by maintaining investment in infrastructure and core social needs
- In environment of tightening credit, government started to coordinate and sequence debt issuances in the broader public sector to minimise interest rate risks
- To ensure state-owned entities contribute to development mandate during the downturn, government provided guarantees and recapitalised selected development finance institutions

Developments post the Financial Crisis, 2008

South Africa's sovereign credit rating downgraded in 2012 –

- Due to raising debt levels, unemployment, socio –economic stress and diminishing of government institutional strength

- Rating agencies acknowledge country's debt position – remained or even better than its peers and developed countries

Developments post the Financial Crisis, 2008

Debt Management in South Africa come a long way –

- Active investor relations programme remains integral part of debt management strategy
- Debt Market is deep and liquid, with no barriers to enter – easy for international investors to access (holds 38% of total domestic debt stock)
- First African Country to be listed on Citigroup World Global Bond Index
- Able to share experience with our fellow African Countries
- Huge infrastructure needs – debt capital markets continue to play vital role

Conclusion

- Evolving nature of debt objectives that support macroeconomic policies
- There is better coordination of
  - Monetary policy and fiscal policy
  - SOC's Funding activities/plans/programme
  - Part of future direction and developments in Bond Market
- Established bench marks in both domestic and foreign markets
- Debt Sustainability, demand and supply analysis
- Improved government's cash-flow management efficiency
- Improved customer relations and transparency
- Integrated risks management framework