

Debt management guidelines: 10 years



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Institutional Framework

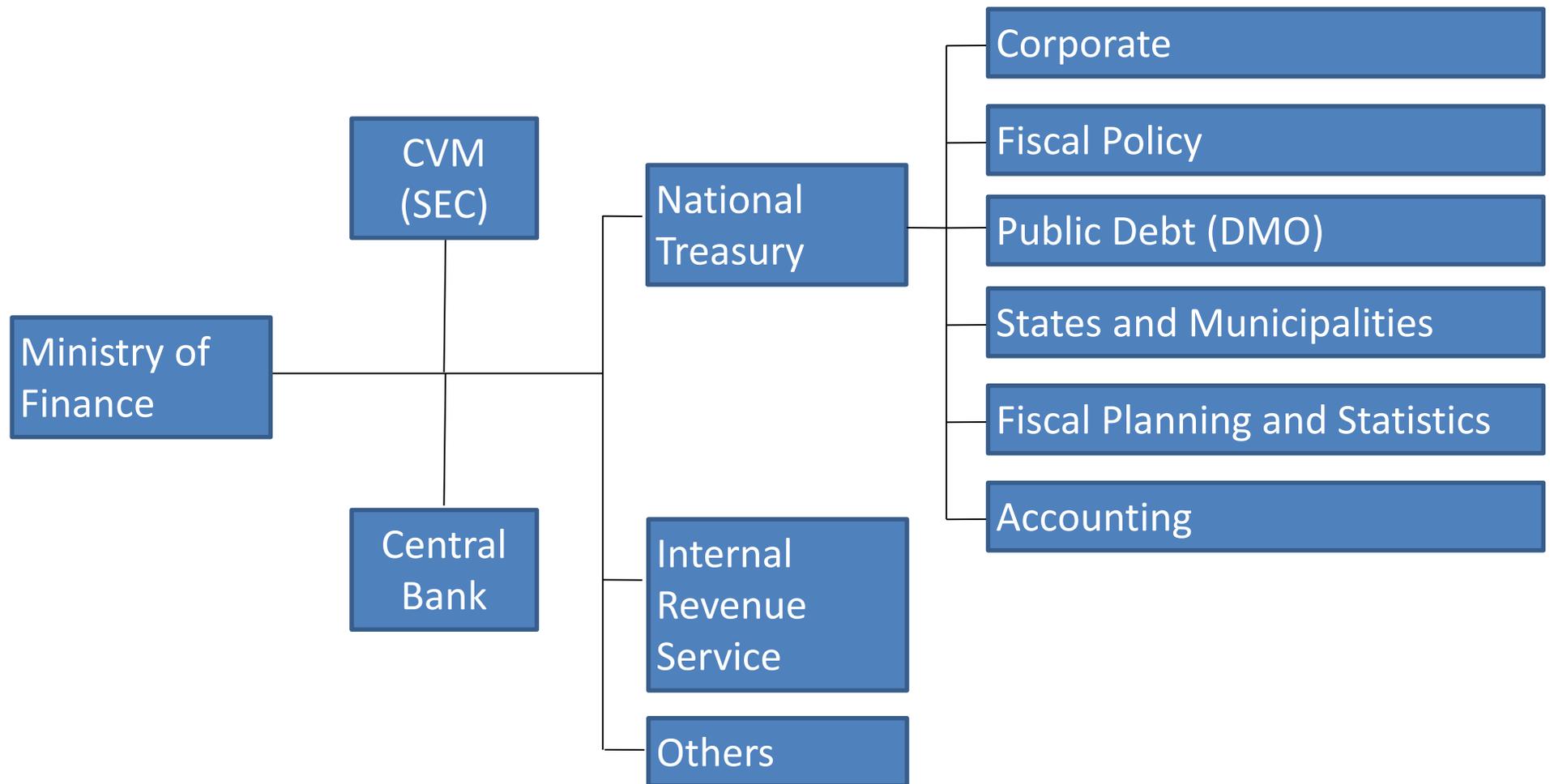
Transparency and Accountability

Debt Management Objectives and
Coordination

Debt Management Strategy & Risk
Management

Development and Maintenance of a Efficient
Market

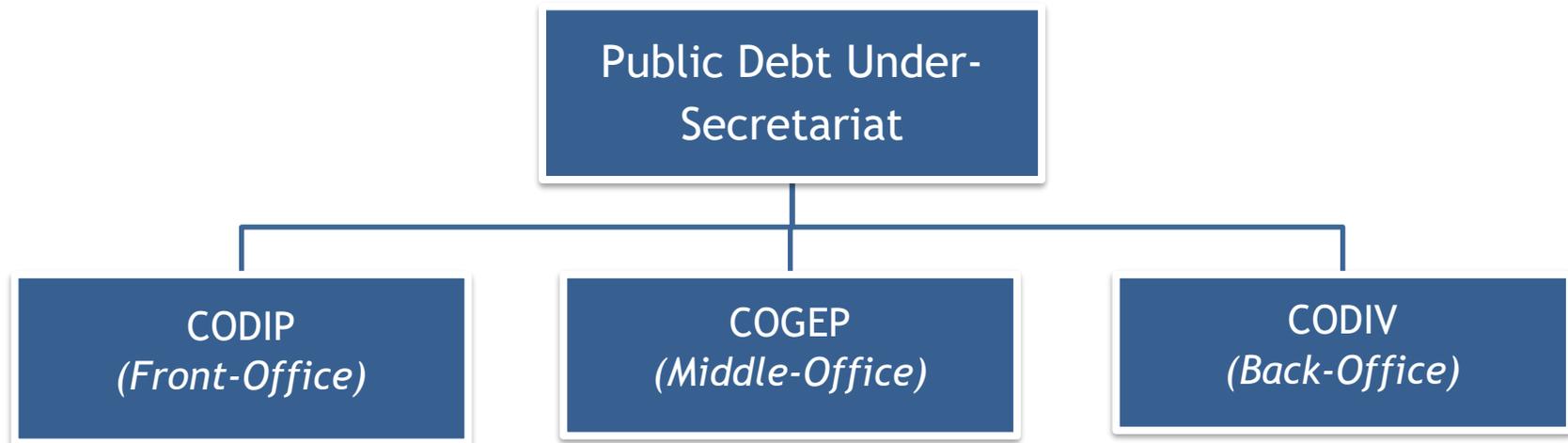
Brazilian Public Debt Management: Institutional Framework



Public Debt Management Institutional Framework and Recent Advances : Governance

- In 1986, the National Treasury was created within the Ministry of Finance.
- In 1999, it was implemented a new model for the public debt management based on a **DMO framework (back, middle e front offices)**, that put the National Treasury in line with the best international practices.
- In 2003, it was created a **Debt Committee**, with (i) strategic meetings, every quarter, to approve the Annual Borrowing Plan and its periodic revisions, and (ii) tactic monthly meetings, to decide the bonds issuance schedule for the following month. The committee has the participation of the Undersecretary for Public Debt and of the heads of the back, middle and front offices.

Public Debt Management Institutional Framework: Governance



Development of short term strategies.

Issuances of bonds in the domestic and external markets.

Evaluation of structured operations involving bonds and contractual debt.

Research and development.

Risk management.

Macroeconomic scenarios.

Domestic and external investor relations.

Register, control, payment and budget monitoring of the domestic and external debts.

Responsible for the official statistics regarding Federal Public Debt.

House keeping

“Public debt management requires staff with a combination of financial market, economics, and public policy skills. Regardless of the institutional structure, the ability to attract and retain skilled debt management personnel is crucial, both for developing and executing an effective strategy and for mitigating key-person risk” (World Bank, 2007).

- The Ministry of Finance (National Treasury) selection process is designed to attract professionals with solid backgrounds in economics and finance.
 - It also offers development and qualification programs for its technical staff, together with institutions that focus on professional specialization.

- Adoption, in 2005, of a Code of Ethics and Standards of Professional Conduct for National Treasury staff:
 - The code was designed to create rules/principles to guide relations with the financial market, the main buyer/holder of public bonds.

House keeping

The guidelines also state that debt management needs a single, secure information system to record debt data, ensure payments, and improve transparency; if multiple systems exist, they can create obstacles to tasks that require consolidated debt information, such as analyzing data and developing strategies.

- The Treasury is developing an integrated system that incorporates the existing ones.
 - » Current systems:
 - » DPI and DIVIDA - Registering and Controlling; ELABORA - Budget Elaboration; GERIR - Risk Management and Strategy Analysis; among other ones.
 - » Under Construction - SID:
 - » Integrate all systems in the DMO; eliminate redundancies; minimize operational risks and Increase capacity of generating useful data
 - » SID first phase (DPI and DIVIDA integration) is expected to be finished in December 2012, being the second one (ELABORA and GERIR integration) delivered until December 2013.

Legal Structure

Best international practices require laws that clearly define responsibilities with respect to issuing new debt instruments, investing, and carrying out transactions for the government.

- In Brazil, these were defined by the Presidential Decree nº 4.643, of 2003, according to which **the National Treasury, within the Ministry of Finance, is responsible for “managing the federal public debt, domestic and external, bonded and contractual”**.
- Brazil’s indebtedness policy is based on **five** legal instruments:
 - ✓ the Federal Constitution, which establishes the general guidelines for public debt;
 - ✓ the LRF - Fiscal Responsibility Law, which defines public finance standards to achieve responsible fiscal management as well as several Federal Public Debt limits;
 - ✓ a specific law that defines the general characteristics of federal public debt bonds;
 - ✓ the Budgetary Guidelines Law (LDO); and
 - ✓ the Annual Budgetary Law (LOA).

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Transparency

According to IMF and World Bank guidelines, it is essential to publicize the goals and responsibilities of debt management to ensure credibility. Such goals, including those related to cost and risk measures, and timely information on financial assets, debt profile and outstanding debt, should be clearly defined and available to the public.

- In Brazil, transparency reduced the market uncertainties related to debt management goals and made political decisions more consistent. It also helped reduce market volatility and the risk premium required by investors.
- The functions and responsibilities of public debt managers are defined by legal instruments that are publicly available on the National Treasury's website, along with regulations related to debt management and primary and secondary market activities.

Transparency : Public Debt Reports

- The most important documents the Brazilian National Treasury publicizes are:
 - ✓ The [Annual Public Debt Borrowing Plan \(ABP\)](#), 12th Edition: Public Debt objectives, guidelines, strategies and targets for the end of the year;
 - ✓ The [Annual Debt Report](#), 9th Edition: which offers a retrospective analysis for the ABP;
 - ✓ The [Monthly Debt Report](#), which presents information and overall statistics;
 - ✓ [Monthly issuances schedule](#), which, at the start of each month, list the dates of auctions, as well as the bonds to be auctioned in the period;
 - ✓ [Debt newsletters](#), which provides information on issues related to the public debt; and
 - ✓ [Presentations for investors](#), updated weekly, which include information on the public debt. These offer a macroeconomic overview and describe the advances and challenges in PDM, highlighting the Treasury's financing strategy

These documents are released in Portuguese and English, sent by our mailing list and available in the National Treasury's website (www.tesouro.fazenda.gov.br).

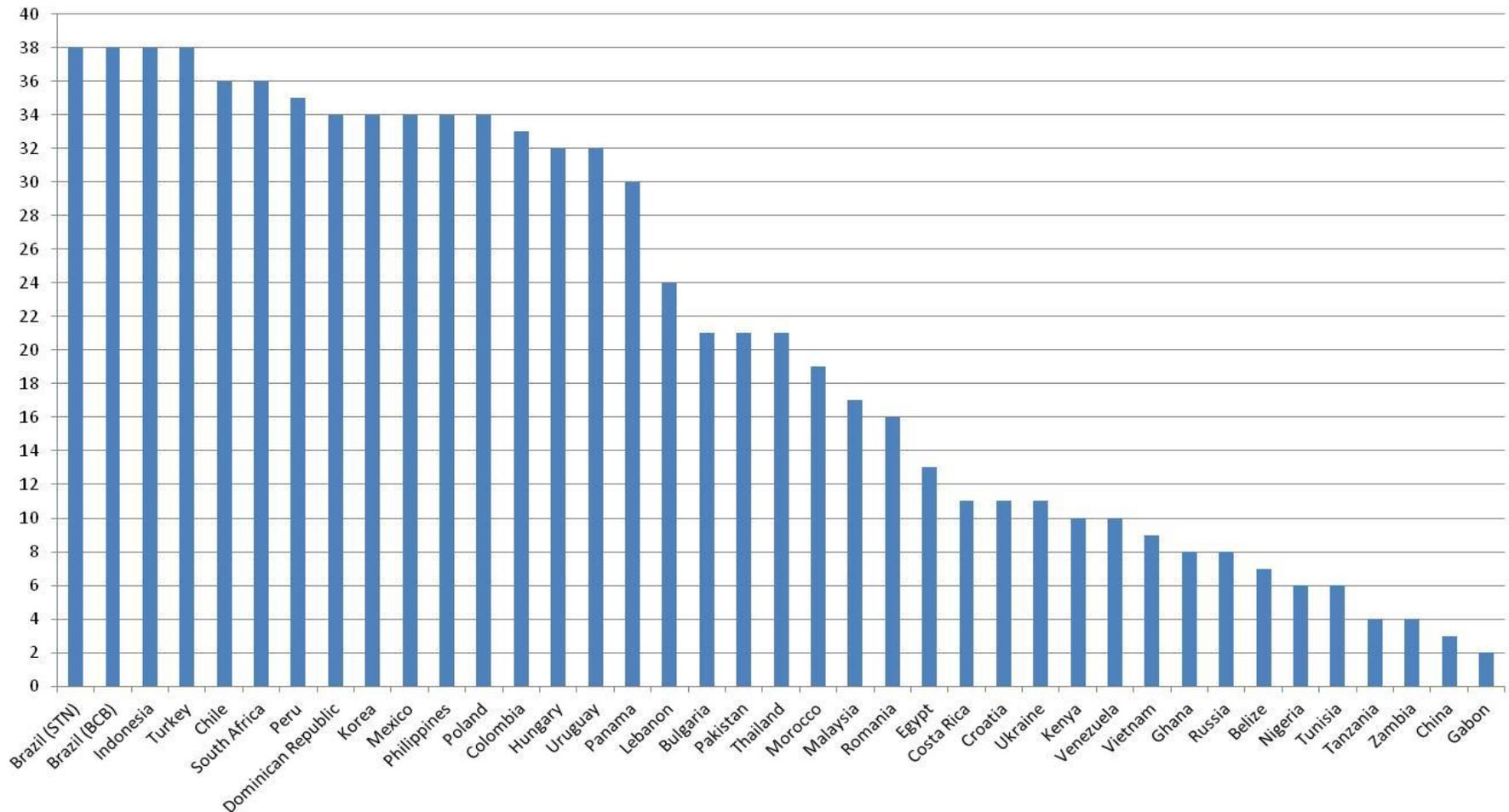
Transparency : Institutional Relations Office

- The **Public Debt Institutional Relations Office** has been key to ensuring that policies would be transparent and the Treasury's actions (as the manager of public debt) would be publicized.
- It was also crucial in expanding the investor base, conducting regular meetings with risk-rating agencies and updating the website with relevant information for investors and the public.
- Also, the Institutional Relations Office releases statements made by government representatives at national and international events.
- Finally, it arranges for regular teleconferences in which the Treasury secretary talks with domestic and foreign investors to describe the latest policies on PDM, fiscal issues, etc., that investors and the public need to know.

Brazil stands out in Investor Relations Best Practices

IIF Report - Investor Relations: An Approach to Effective Communication and Enhanced Transparency

Assessment of Investor Relations and Data Transparency Practices Ranking



Accountability: External Audits

Good debt management practices suggest that external auditors should review activities annually. These audits should evaluate the institutional environment (organizational structures and information systems), operational risks, information flows, and monitoring of internal controls.

- Brazilian debt management is audited internally each year by the Office of the General Comptroller (CGU), an agency of the executive branch.
- Externally, by the Federal Court of Accounts (TCU), within the legislative branch.
- Besides that, the Federal Executive has to account its results to the Legislative every term. Public Debt results is presented in a formal report accounting for the overall government balance sheet (BGU).

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Federal Public Debt objectives and guidelines: released every year through the ABP

➤ 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.

Based on that long term objectives, the **guidelines** set for 2012 are the following:

- ✓ Gradual replacement of floating-rate securities by fixed-rate and inflation-linked instruments;
- ✓ Increase the average maturity of the outstanding debt;
- ✓ Smooth the maturity profile, with special attention given to short-term maturities;
- ✓ 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; and
- ✓ Improvement of the External Federal Public Debt (EFPD) profile through issuance of benchmark securities, buyback program and structured operations.

Coordinating Public Debt Management with Fiscal and Monetary Policies

According to the IMF and World Bank guidelines, public debt and fiscal policy managers and central bank authorities must share the same policy goals, given the inter-dependence of their instruments.

- In countries with more developed, efficient financial markets, debt management and monetary policy are clearly separated, which reduces possible conflicts
- Countries less able to separate the goals and responsibilities face greater challenges.
 - in most cases, these arise mainly because the countries lack a developed bond market and an independent central bank;
 - also, because they adopt similar market instruments for both monetary and debt policies.
- With respect to the latter, in Brazil, until the Fiscal Responsibility Law (LRF) was passed in 2000, the Central Bank used its own bonds to conduct monetary policy.

Coordinating Public Debt Management with Fiscal and Monetary Policies

- In 2000, the **Fiscal Responsibility Law** was approved, stating that, **from 2002 on**, the Central Bank was prohibited from issuing bonds to execute monetary policy:
 - » **Fiscal Policy** (budget deficits financing): conducted by the National Treasury through securities issued in its primary market auctions.
 - » **Monetary Policy** (control of monetary aggregates): conducted by Central Bank through treasury securities traded in Secondary Markets (Open-Market operations), among other instruments.
- **Since 2005** the centralization of Federal Public Debt became stronger, with the change of issuance of **external debt bonds from Central Bank to the Treasury**.
- This **centralization** was **fundamental** for the **Treasury to enhance the debt management**: (i) its objectives and guidelines started to be fully reflected on the day-to-day debt strategy; (ii) the institutional relations unit started to continuously assist the rating agencies; (iii) road shows were organized regularly in the main international financial centers; and (iv) the operations desk was created to execute the external debt operations.

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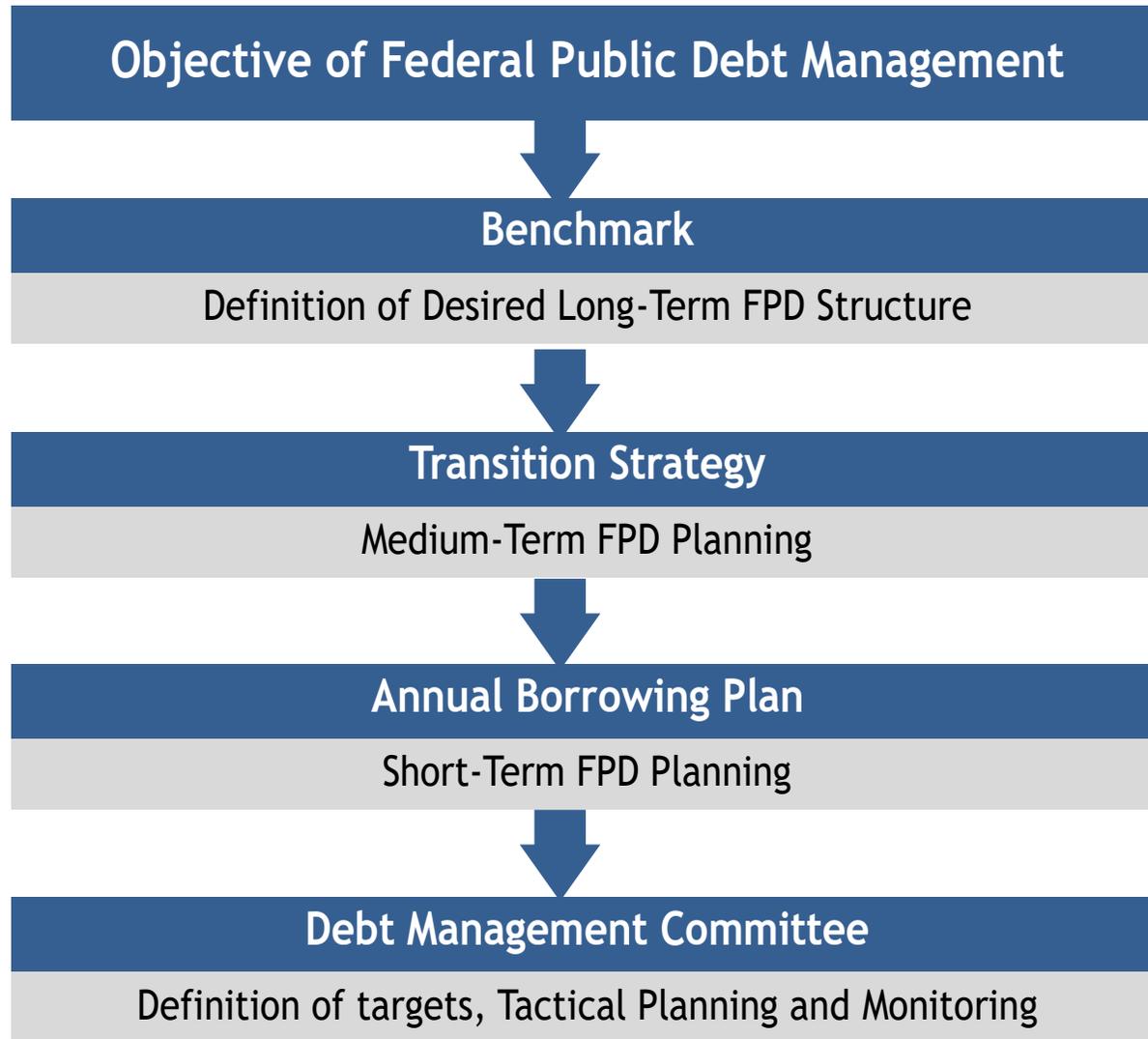
Development and Maintenance of a Efficient
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Public Debt Management strategy and risk management

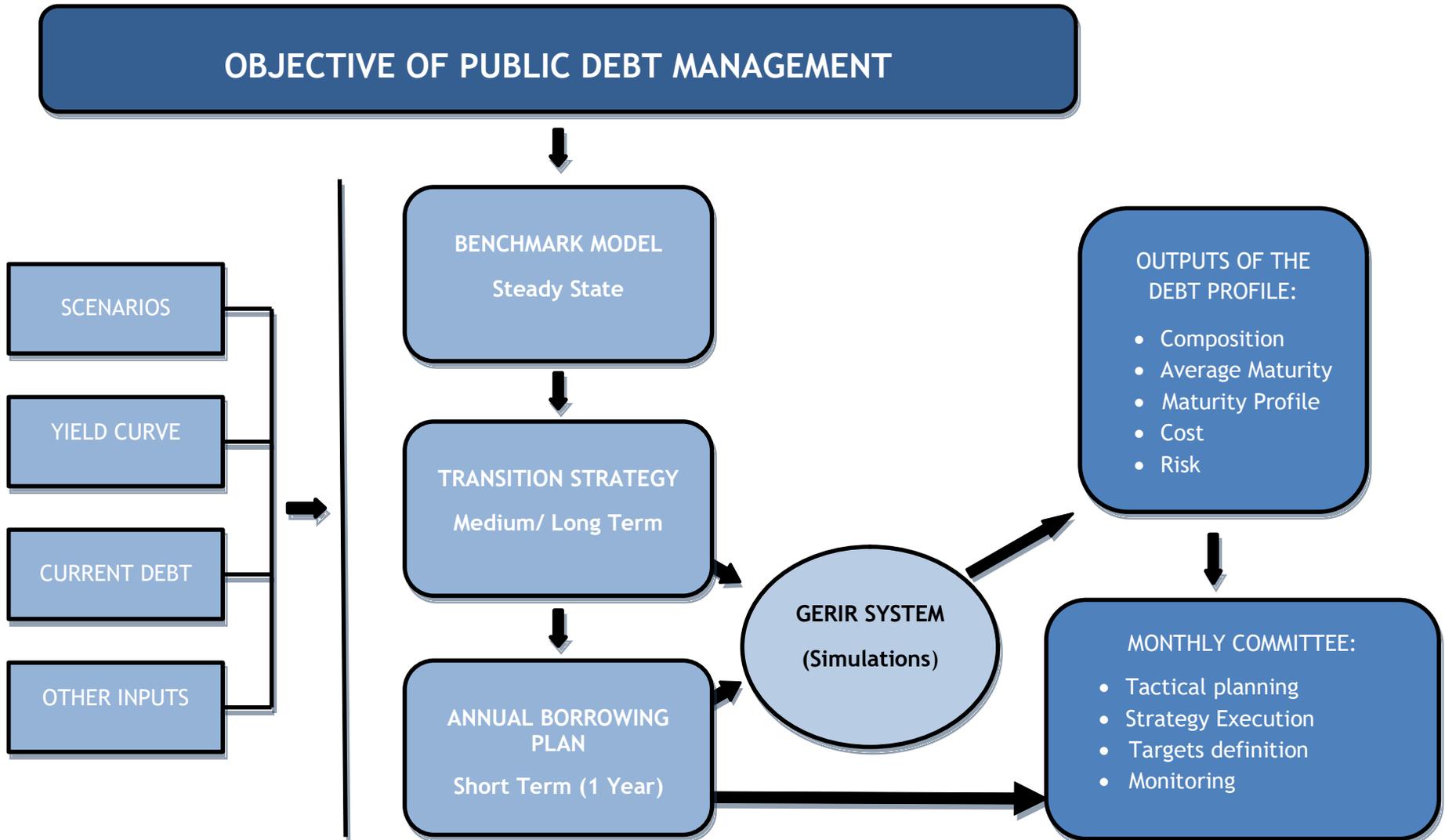
The most important elements of Public Debt Management are a consistent, sustainable strategy for the public debt based on cost and risk analyses that consider macroeconomic and market restrictions and a developed domestic market (World Bank, 2007).

- Guidelines advocated by debt strategy experts stress the importance of monitoring and evaluating risks in the debt structure
- Managers should be concerned about risks associated with variations in interest and exchange rates, and in securing debt payment and refinancing.
- The strategy should assess distinct medium and long-term debt structures for defining optimum debt profiles which would help managers identify and manage cost-risk tradeoffs.
- It should also consider macroeconomic restrictions and the market's level of development

Strategic planning process of the Federal Public Debt



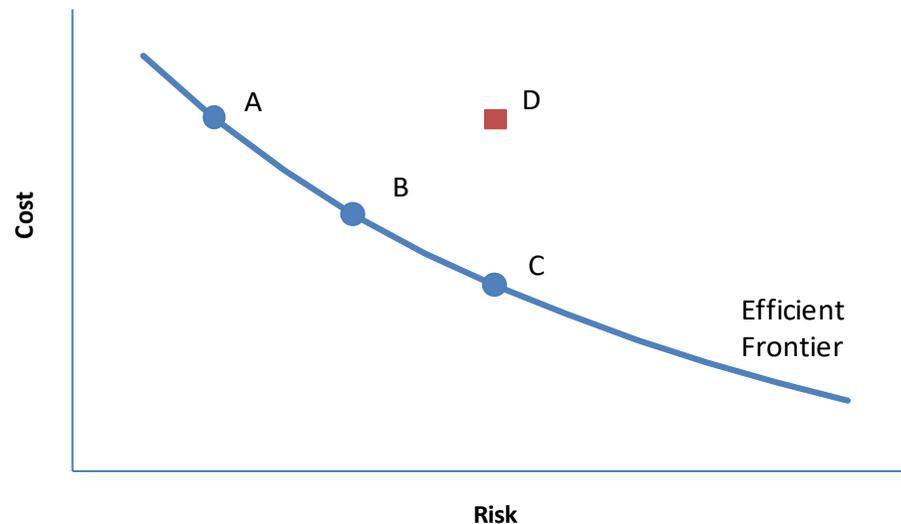
Strategic Planning Process of the Federal Public Debt



1st Stage: the Desired Long Term Debt Composition - Cost and Risk Evaluation

- Optimal portfolio selection
 - Financing efficient frontier
 - Trade-offs performed by the model
- To determine the optimal portfolio (benchmark) it is necessary to choose the risk appetite of the government (in last instance, the taxpayers aversion to risk)
- Application of the model to measure performance: criterion based on the efficient frontier

Efficient Frontier: Cost-Risk Tradeoff



1st Stage: Indicative Intervals of Desired Long-Term Composition released in the ABP

Composition	Lower Limit	Upper Limit
Fixed Rate	40%	50%
Inflation Linked	30%	35%
Floating Rate	10%	20%
Exchange Rate	5%	10%

Maturity Profile	Lower Limit	Upper Limit
Average Maturity	5 Years	6 Years

2nd Stage: The Transition Strategy

- The transition strategy establish a **bridge between short and long term**
- It seeks to evaluate risks, restrictions and opportunities for FPD management over a period of time longer than the current fiscal year, usually **five years**
- It seeks to develop a plan that will lead FPD to the profile indicated by benchmark, with due consideration of the current debt composition and its maturity structure
 - what should be the path and the speed of convergence of the debt portfolio to the benchmark ?
 - what may constitute short and medium-term constraints (particularly, macroeconomic environment and development of local financial markets) ?
- One important distinction between the benchmark and the transition/ABP strategy is that scenarios in the first case presume economy in the steady-state, while the transition/ABP strategy takes as reference a set of possible scenarios for the coming years.

2nd Stage: The Transition Strategy

Indicators	2011	2012	2013	2014	2015	2016
Stock of FPD (R\$ billion)						
	1.868,1	2.089,9	2.295,9	2.487,3	2.743,1	2.998,9
Profile (%)						
Fixed Rate	37,3	37,5	40,6	41,6	43,9	46,2
Floating Rate	30,9	29,5	25,3	23,1	19,8	16,7
Exchange Rate	5,1	4,6	4,4	4,2	3,8	3,4
Inflation-Linked	26,7	28,4	29,7	31,1	32,5	33,9
Outstanding Structure						
Average Maturity (in years)	3,6	3,6	3,8	4,0	4,1	4,1
Issuance Average Maturity (in years)	4,2	4,3	4,1	4,3	4,0	4,0
% Maturing in 12 months	23,0	26,9	28,4	25,6	19,5	19,5
% Maturing in 24 months	46,5	51,7	50,2	41,9	40,1	40,1
% Maturing in 36 months	63,1	65,8	59,1	55,9	54,1	54,1

3rd Stage: The Annual Borrowing Plan – Federal Public Debt 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

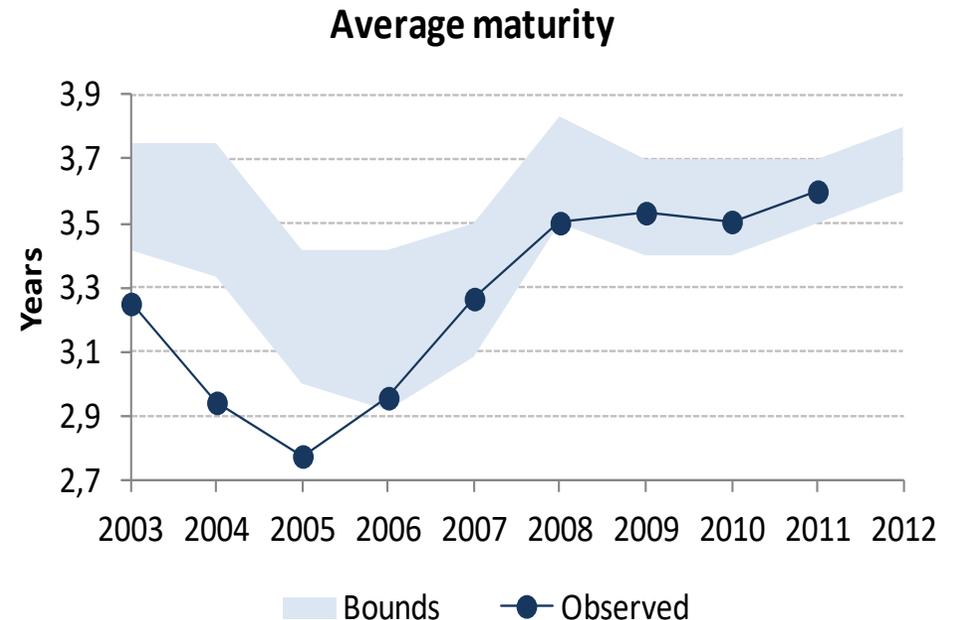
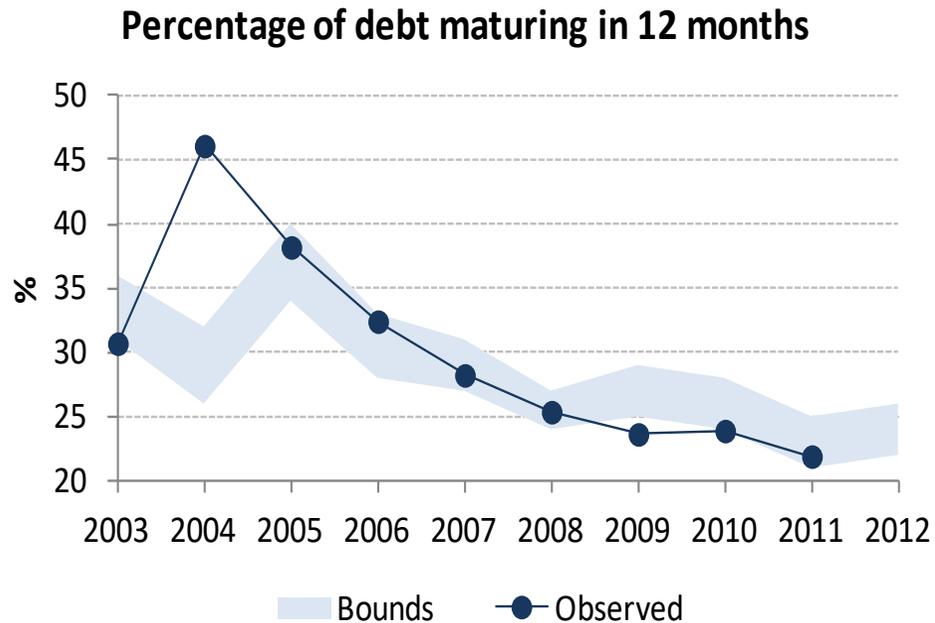
3rd Stage: The Annual Borrowing Plan – Federal Public Debt targets to the end of the year

- Targets are published in the Annual Borrowing Plan as limits for the debt profile

Indicators	2011	Limits for 2012	
		Minimum	Maximum
Stock of FDP (R\$ billions)			
	1,866.4	1,950.0	2,050.0
Profile (%)			
Fixed Rate	37.2	37.0	41.0
Inflation Linked	28.3	30.0	34.0
Floating Rate	30.1	22.0	26.0
Exchange Rate	4.4	3.0	5.0
Maturity Structure			
Average maturity (years)	3.6	3.6	3.8
% Maturing in 12 months	21.9	22.0	26.0

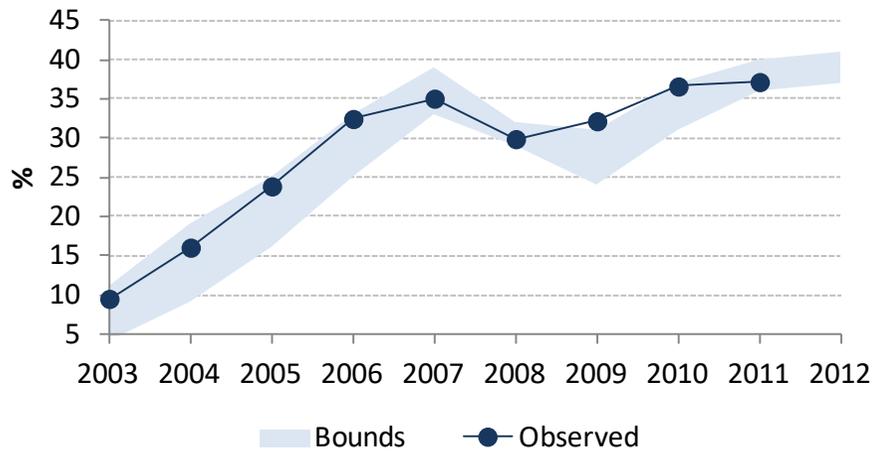
Federal Public Debt Annual Borrowing Plan (ABP) main results

➤ In fact, the National Treasury's planning and execution of FPD management activities has been strengthened over the years, which has guaranteed the quality of results:

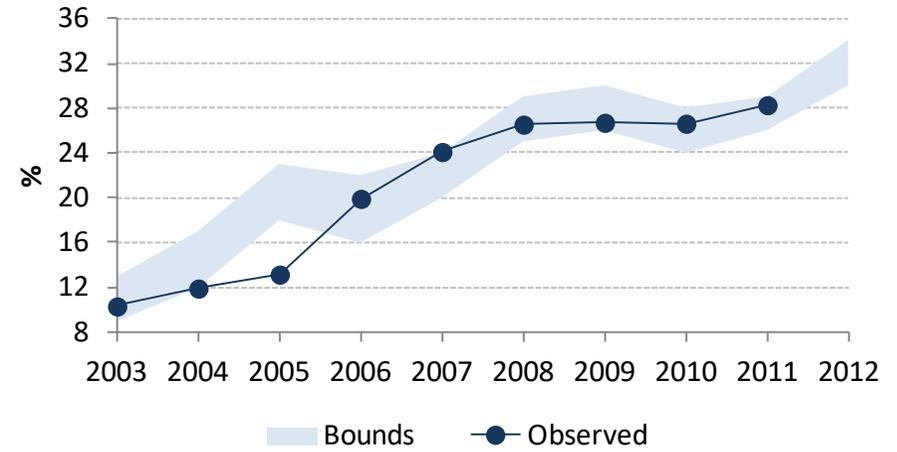


Federal Public Debt Annual Borrowing Plan (ABP) main results

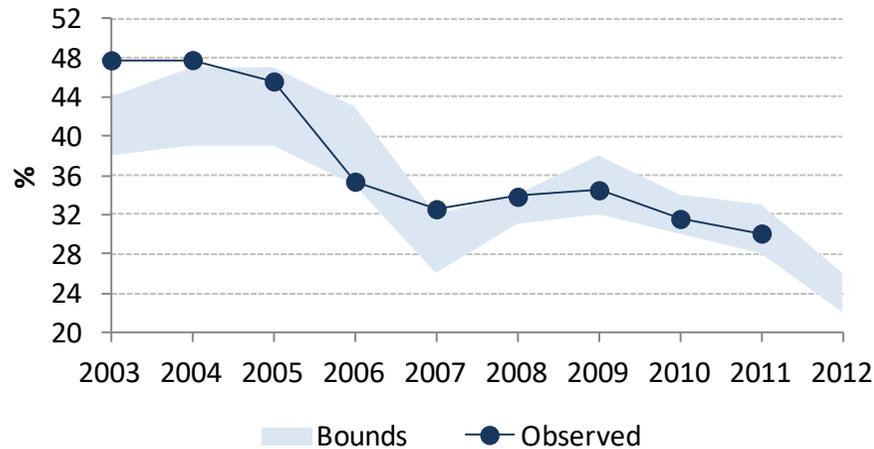
Fixed rate debt



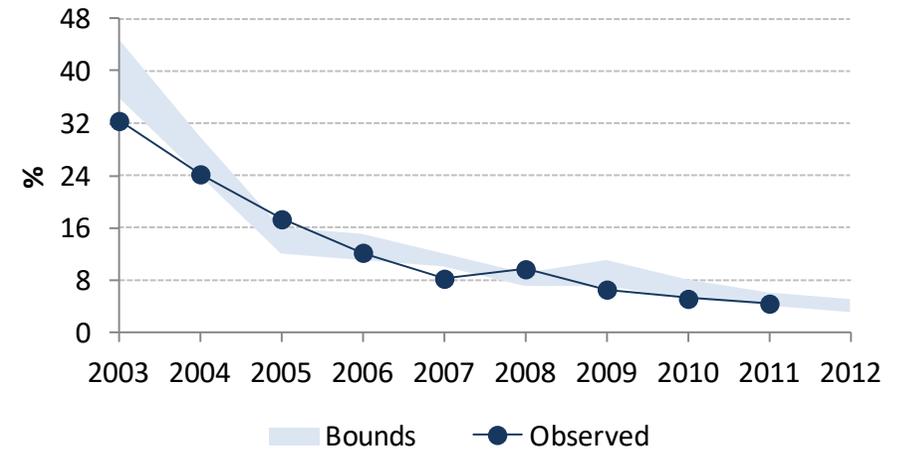
Inflation-linked debt



Floating rate debt



FX-linked debt



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Development and Maintenance of an Efficient Market

Frequency of the Auctions for the whole year – as stated in the Annual Borrowing Plan

Bond	Type of Auction		
	Traditional	Exchange	Buy Back
LTN	Weekly	Semiannually	-
NTN-F	Twice monthly	-	Monthly
LFT	Monthly	-	-
NTN-B	Twice monthly	Monthly	Monthly

- **Traditional auctions:** have the principal function of refinancing the Federal Public Debt through issuance of fixed rate, floating rate and inflation linked bonds;
- **Exchange auctions:** consist primarily of exchanges of bonds with shorter maturities for other longer-term bonds, with the overriding objective of lengthening the debt profile; and
- **Buy Back:** to provide investors with higher liquidity.

The official schedule of auctions for the following month is published every month end at the web site:
http://www.stn.fazenda.gov.br/divida_pública/leiloes.asp.

Development and Maintenance of an Efficient Market

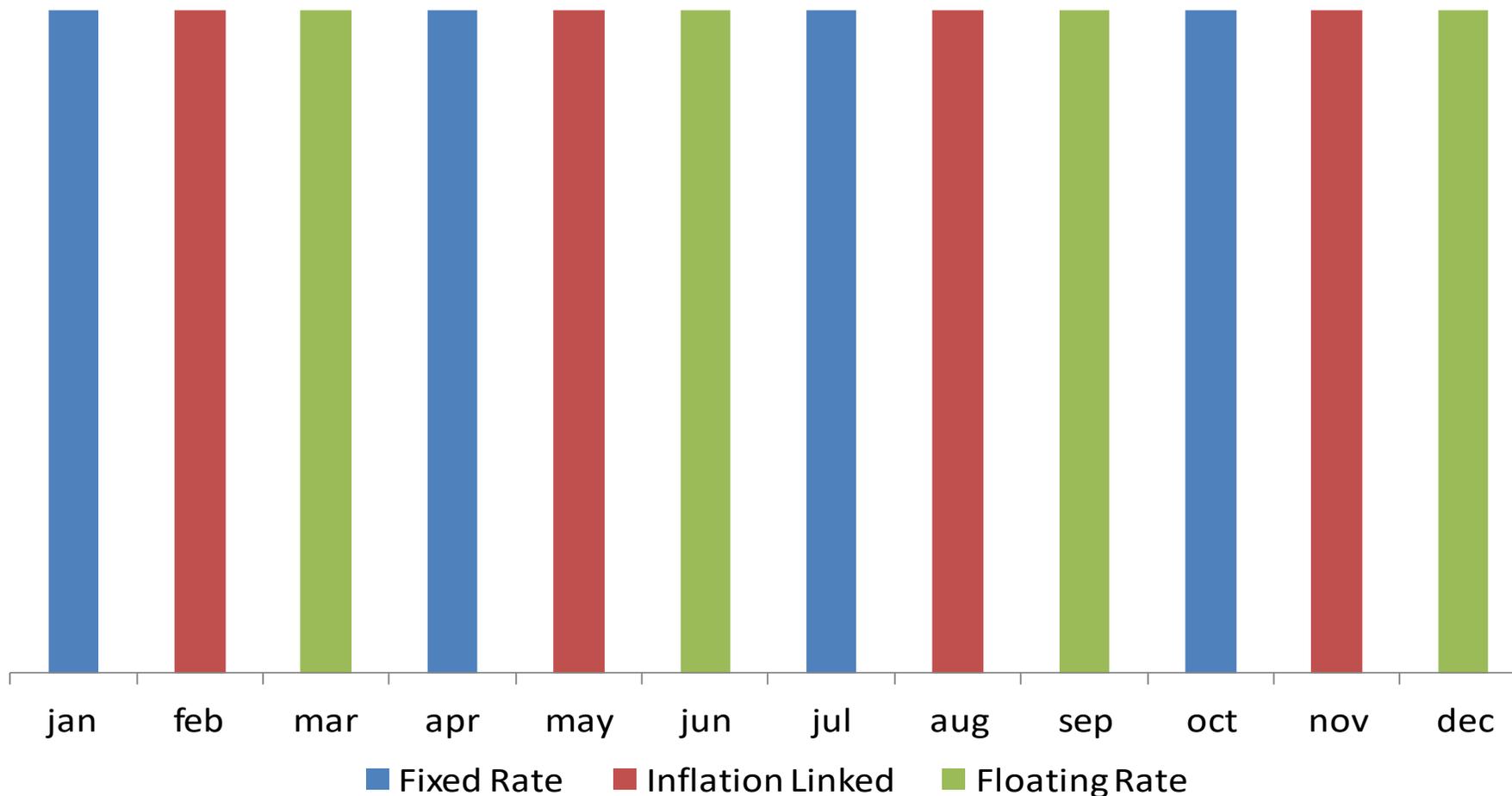
Benchmarks and Maturities – as stated in the Annual Borrowing Plan

Type of Yield	Bond	Benchmark	Maturities
Fixed Rate	LTN	Short and medium term Within 4 years (4 maturity points)	January, April, July and October
	NTN-F	Long Term Between 5 and 10 years (2 maturity points)	January
Floating Rate	LFT	Maturity greater than average FPD maturity	March and September
Inflation Linked	NTN-B	Group I-Short and medium term Within 10 years (3 maturity points)	May and August
		Group II-Long term 20, 30, 40 years (3 maturity points)	

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Development and Maintenance of an Efficient Market

Standardized Maturity Structure for Debt Securities: Creation of benchmarks



Development and Maintenance of an Efficient Market

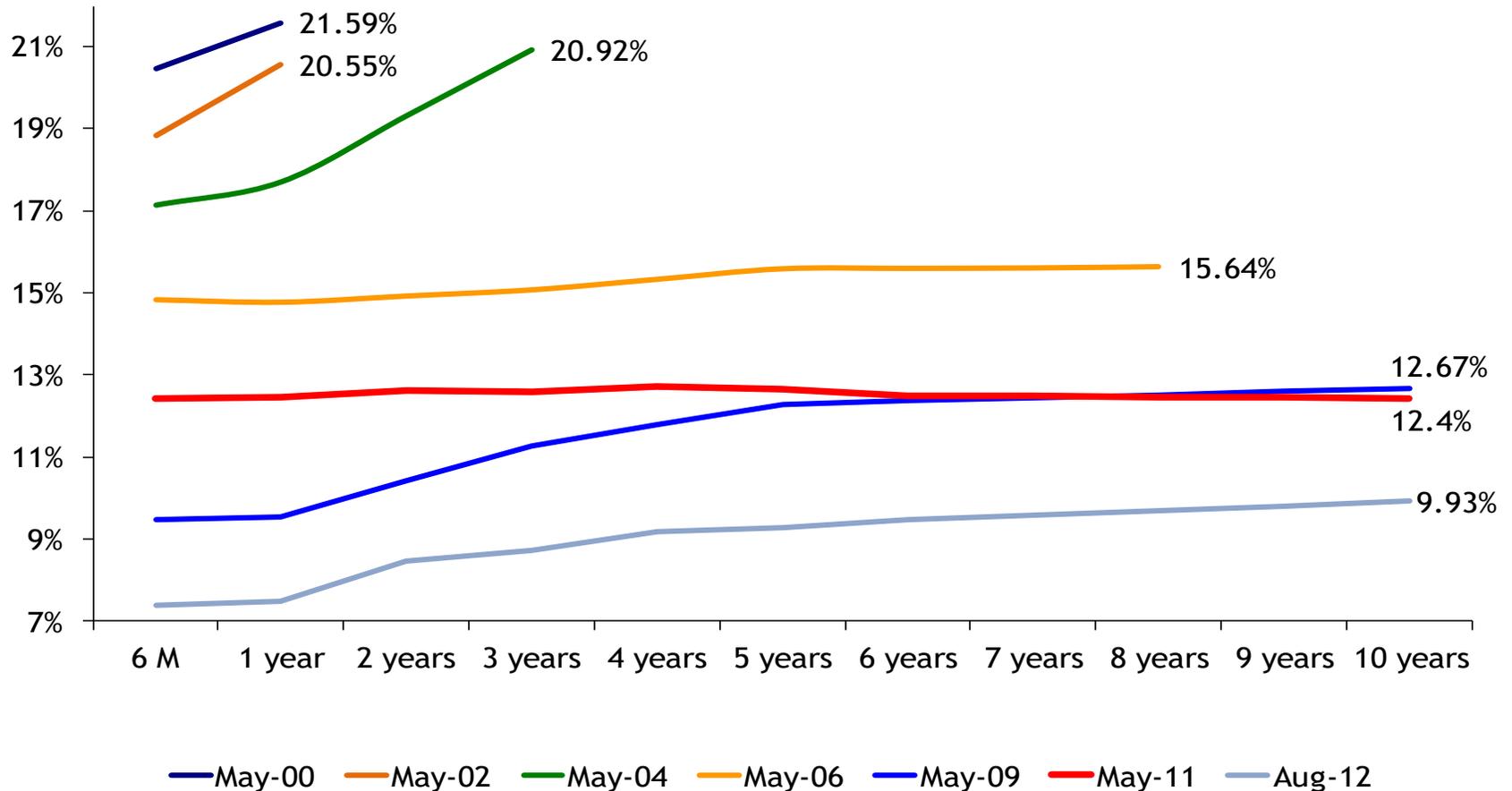
Schedule of domestic debt issuances: released every last Friday before the month of reference

The National Treasury hereby establishes the schedule of domestic debt issuances for March 2012:

AUCTION	TIME	TYPE	SECURITY*	MATURITY
1 st Thursday	11:00-11:30	Traditional Auction	LTN	10/1/2012; 4/1/2014; 1/1/2016
8 th Thursday	11:00-11:30	Traditional Auction	LTN NTN-F	4/1/2013; 4/1/2014; 1/1/2016 1/1/2018; 1/1/2023
13 th Tuesday	12:00-13:00	Traditional Auction Early Redemption	NTN-B NTN-B	8/15/2016; 8/15/2018; 8/15/2022; 8/15/2030; 8/15/2040; 8/15/2050 8/15/2030; 5/15/2035; 8/15/2040; 5/15/2045; 8/15/2050
14 th Wednesday	12:00-13:00	Exchange Auction	NTN-B	8/15/2016; 8/15/2018; 8/15/2022; 8/15/2030; 8/15/2040; 8/15/2050
15 th Thursday	11:00-11:30	Traditional Auction	LTN LFT	10/1/2012; 4/1/2014; 1/1/2016 3/1/2018
21 st Wednesday	11:00-11:30	Exchange Auction	LTN ¹	10/1/2012; 4/1/2013
22 nd Thursday	11:00-11:30	Traditional Auction Early Redemption	LTN NTN-F NTN-F	4/1/2013; 4/1/2014; 1/1/2016 1/1/2018; 1/1/2023 1/1/2018; 1/1/2021
27 th Tuesday	12:00-13:00	Traditional Auction	NTN-B	8/15/2016; 8/15/2018; 8/15/2022
29 th Thursday	11:00-11:30	Traditional Auction	LTN	10/1/2012; 4/1/2014; 1/1/2016

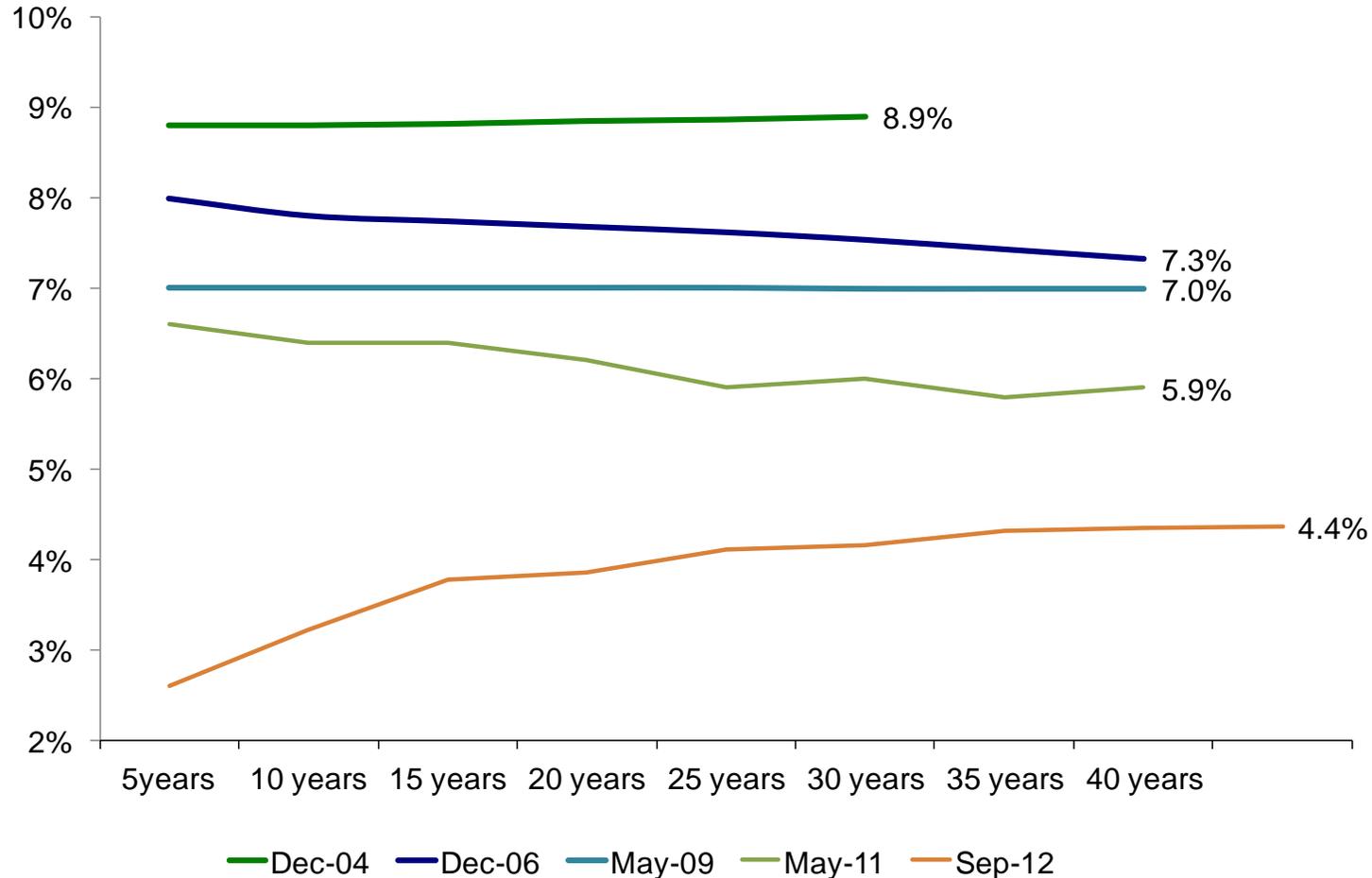
Development and Maintenance of an Efficient Market

Building and extending the local yield curve for Fixed Rate Government bonds



Development and Maintenance of an Efficient Market

Building and extending the local yield curve for Inflation Linked Government bonds



Development and Maintenance of an Efficient Market

Important Steps for Secondary Market Development: Dealership System

- » Aimed at enhancing public securities sales in the primary market, facilitate Central Bank open market operations and improve overall liquidity of securities in the secondary market.
- » Composed by 12 financial institutions, out of which 2 are independent brokerage firms.
- » The dealers are evaluated every six months and the institutions with the poorest performance are eventually replaced by other institutions.

Evaluation Factor	Candidate	Dealer
Secondary market activity	30%	7.5%
Secondary market activity with negotiation objects	-	7.5%
Secondary market activity in eletronic platforms	10%	10%
Repo operations among market participants	25%	15%
Primary market participation (NT auctions)	35%	20%
CB money market operations	-	10%
Relationship with the NT operations desk	-	15%
Relationship with the CB operations desk	-	15%

Development and Maintenance of an Efficient Market

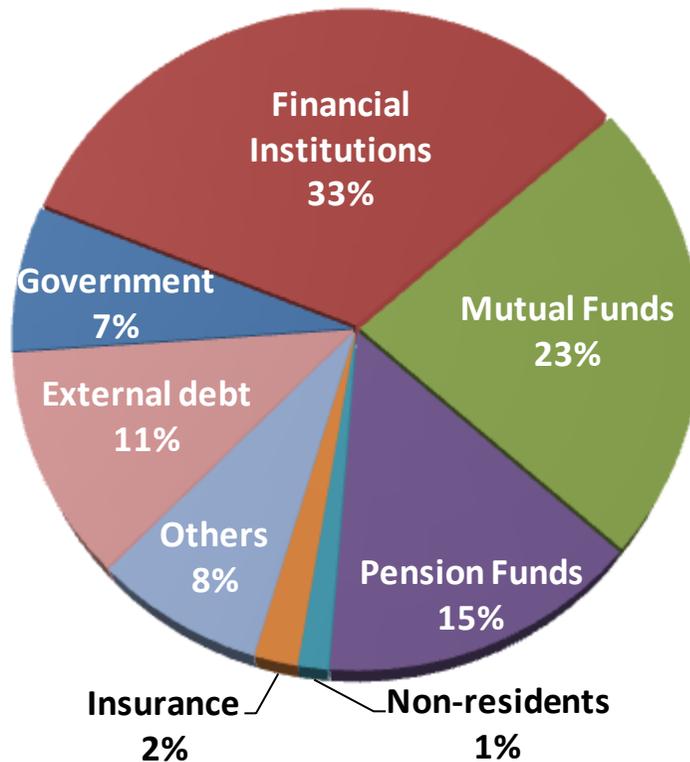
Important Steps for Secondary Market Development: Electronic Trading Systems

- The large majority of Brazilian public securities are traded over-the-counter, but the country has taken some measures to stimulate the use of electronic trading systems:
 - development of three electronic trading platforms: CetipNet (CETIP); Sisbex (BM&Fbovespa) and E-bond (Bloomberg);
 - evaluating factor for dealers
 - some benefits for pension funds (less legal procedures).

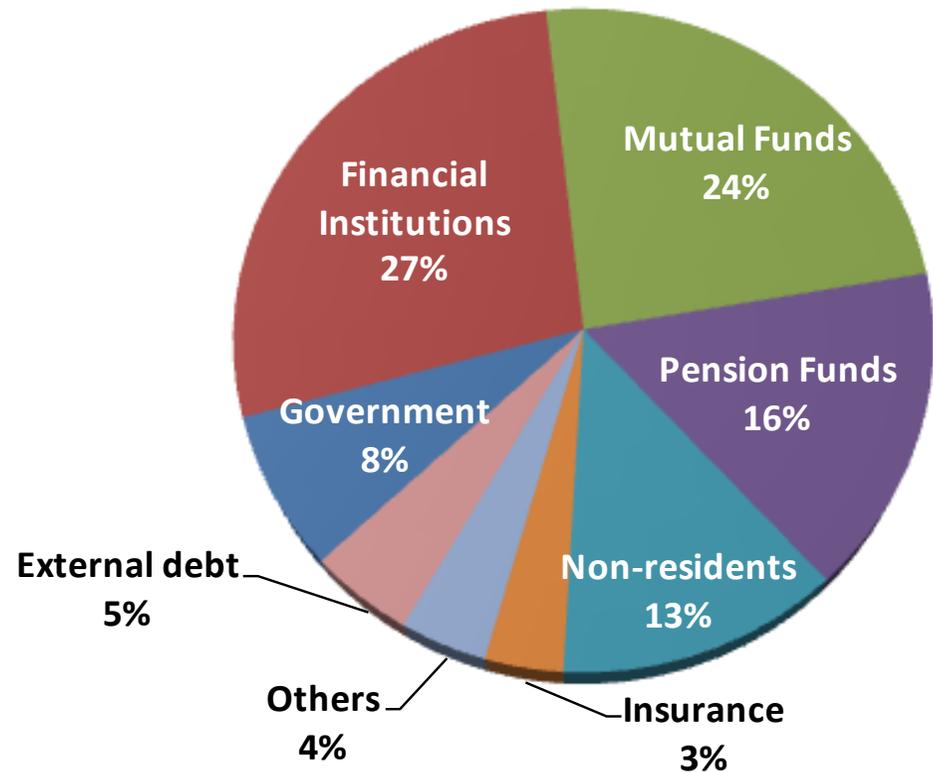
- Advantages of using these systems:
 - greater transparency
 - better pricing of the assets traded
 - increased liquidity of the secondary market
 - greater accessibility to a broader base of investors

Important Steps for Secondary Market Development: Broadening the Investors base

Public Debt Holders - Snapshot (Jan 2007)



Public Debt Holders - Snapshot (Aug 2012)



This is the result of a long term strategy adopted by the National Treasury aimed at diversifying the investor base.

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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