In almost every country, the institutions that manage the assets of a sovereign are different from those that oversee the liabilities, often with clearly separate mandates for including the maximization of the return on the assets or the minimization of the funding costs.

The main objective of sovereign liability management, of which the government debt portfolio is often the largest component, is to ensure financing of the budget at the lowest possible cost subject to an acceptable level of risk. Depending on the time horizon for the holdings, the objective of sovereign asset management can vary from ensuring the liquidity needed to meet given expenditure plans to earning a competitive rate of return, all while always keeping risk under control.

But the sound macroeconomic management requires entities with different policy-making mandates to coordinate, ensuring consistency and reinforcing all policies while continuing to provide resiliency against economic shocks. Having a holistic view of the sovereign balance sheet paints a complete picture for analyzing and managing the potential risks and opportunities for the financial position of the government.

As long as the roles, objectives and resources of the institutions involved in SALM are clear, a SALM approach could ensure appropriate coordination in the management of assets and liabilities across institutions while continuing to maintain each institution’s independence.

WHAT IS SOVEREIGN ASSET AND LIABILITY MANAGEMENT APPROACH?

Sovereign asset and liability management is the process of managing assets and cash flows to meet the government’s financial obligations at the lowest possible cost with a prudent level of risk. This approach requires analyzing the mismatches in currency and interest rate composition, the timing of the cash flows, existence of natural hedges, and over time, choosing the assets and liabilities with matching characteristics and/or employing financial derivatives to enable sovereigns to more effectively manage their risk to achieve identified, desired risk levels.

The SALM framework also provides an opportunity to conduct sovereign portfolio stress testing, allowing countries to optimally manage their sovereign debt and asset portfolios.
World Bank Treasury Sovereign Balance Sheet Risk Management (B-RISK) Program provides expert advice, an extensive learning program, and operational support to its clients to develop a framework for the joint management of financial assets and liabilities.

The sovereign asset and liability management (SALM) approach is inspired by practices from the financial sector. It allows governments to have a better assessment of the sovereign’s financial risks and manage such risks in a cost-efficient way, utilizing natural hedges or enhancing the return of their assets through better allocations.

The World Bank Treasury, with over 70 years of experience in capital markets, manages IBRD’s approximately US$200 billion debt portfolio and has issued bonds and notes in more than 60 currencies. Furthermore, it manages assets of approximately US$200 billion, which includes assets of the World Bank Group and more than 50 official sector institutions, including central banks, pension funds, sovereign wealth funds, and other multilateral organizations.

The World Bank Treasury, is uniquely positioned in the balance sheet risk management field, managing IBRD’s own market risk through the heavy use of derivatives to match the interest rate and currency risks of its assets and liabilities. The Treasury also intermediates asset and liability transactions and manages investment operations on behalf of its clients to earn a competitive rate of return, under the same standards of care utilized to manage the World Bank’s own assets.

The B-RISK Program derives expertise from The World Bank Treasury’s own asset and liability management experience as well as the practitioner know-how of its world-class technical advisors. Harnessing the convening power of the World Bank Treasury, the Program offers a unique service to its clients in designing and implementing the SALM framework. The Program is not only designed to serve as a one-stop shop, but also as a modular program to allow clients to tailor each engagement to their specific needs.

WHY IS SOVEREIGN ASSET AND LIABILITY MANAGEMENT IMPORTANT?

Having a holistic view of the sovereign balance sheet actually paints a more complete picture when analyzing and managing the potential risks and opportunities of the government. Sovereign’s balance sheet items, such as cash reserves, tax revenues, dividends from state-owned enterprises, international reserves, government debt, pensions, and guarantees are typically analyzed and managed as separate sub-portfolios by different institutions. Having an overarching strategy to manage the exposure of the overall balance sheet can draw attention to vulnerabilities, help sovereigns reduce interest rates or exchange rate mismatches, and lower the cost of risk reduction through utilizing natural hedges.

THE B-RISK PROGRAM IS MODULAR, ALLOWING CLIENTS TO TAILOR EACH ENGAGEMENT IN LINE WITH THEIR NEEDS

B-RISK ADVICE

An advisory engagement usually begins with an assessment, which includes an analysis of the balance sheet risks to identify natural hedge opportunities, and an evaluation of the institutional capacity to actively manage these risks. The second part of the B-RISK Advice is to design a reform plan to enable sovereigns to more effectively manage risk while considering both sides of their balance sheet. Focus areas of B-RISK Advice include:

- Legal and organizational framework
- Asset and liability management strategy
- Operational framework
- Coordination with monetary and fiscal policies
- Integration of cash and debt management
- Comprehensive reporting on costs and risks under an SALM framework

MODULE I – B-RISK ADVICE

The B-RISK Program is designed in modules to help clients build their own capacity and/or execute operations on their behalf. Program members have a selection of options at their disposal to customize the level of engagement: they can pick and choose modules from having an assessment and reform plan through B-RISK Advice module, to developing institutional capacity through participating in the B-RISK Learning module, or to outsourcing part of their Asset and/or Liability Management Operations.

MODULE II – THE B-RISK LEARNING

The B-RISK Learning module provides hands-on training and workshops, such as cash management, asset and liability management, debt management strategies, contingent liabilities, portfolio management, and asset management; discussion meetings with senior and executive staff; South-South experience sharing; and internships at the World Bank Treasury on different areas of sovereign asset and liability management.

MODULE III – LIABILITY MANAGEMENT OPERATIONS

- Assessment: evaluation of the exposures of debt portfolio to changes in market risk variables.
- Design: design and execution of transactions such as buy-backs, debt-swaps and derivatives.
- Liability management: managing the market risk of the debt portfolio.

MODULE IV – ASSET MANAGEMENT OPERATIONS

- Assessment: assessment of the impact of different spending rules and asset allocations.
- Design: design, selection and execution of transactions.
- Asset management: overall asset management support and the management of foreign currency cash balance in coordination with the World Bank’s Reserves Advisory and Management Program (RAMP).

MODULE V – JUST-IN-TIME SUPPORT (JITS)

We support clients with specific requests on technical issues or are at the initial stages of needs assessment.