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Contingent Liabilities

by

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD

MANAGEMENT OF CONTINGENT FISCAL LIABILITIES EXPOSURES: THE SA EXPERIENCE

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SCOPE - IMPLICIT CONTINGENT LIABILITIES

- **Undisclosed implicit contingent liabilities:**
  - Bank failure and
  - Disaster relief

- **Disclosed implicit contingent liabilities:**
  - Road Accident Fund (RAF);
  - South Africa's Special Risk Insurance Association (SASRIA);
  - Unemployment Insurance Fund (UIF);
  - Compensation Fund (CF); and
  - Export Credit Insurance Corporation of South Africa SOC Limited (ECIC).

IMPLICIT CONTINGENT LIABILITIES (continues)

- Contingent liabilities from a banking system failure is managed and mitigated through a robust regulatory framework, which shielded SA banks from the 2008 crisis.
- The national budget includes a contingency reserve, which may be used for natural disasters.
- The Annual Division of Revenue Act (DoRA) specifies unallocated funds to any province or municipality that may be released within 3 days up to 3 months following a disaster.
- In terms of DoRA, unspent allocations related to infrastructure may be reallocated for reconstruction and rehabilitation.
- This presentation will focus on explicit contingent liabilities.

LEGAL FRAMEWORK

PUBLIC FINANCE MANAGEMENT ACT (PFMA)

Section 66 of the PFMA prescribes:

The powers of Government and the Public Entities to borrow money, issue guarantees, indemnities and or securities that may bind the National Revenue Fund.

Section 70 of the PFMA stipulates:

The responsibility of Cabinet members for the issuance of guarantees, indemnities and or securities as well as duties of the responsible Cabinet Member. It also stipulates that the Minister of Finance has to concur with the issuance of such guarantees, indemnities and or securities

The PFMA gives effect to sections of the Constitution of South Africa that deals with Finances of the country and requires national legislation

POLICY FRAMEWORK

UNDERLYING PRINCIPLES

- NT to operate within an appropriate Credit Risk environment;
- Credit risk inherent in all new activities must be subject to adequate controls (procedures);
- NT must operate under a sound credit granting process;
- An appropriate credit administration, measurement and monitoring process must be maintained;
- NT established independent Fiscal Liabilities Committee (FLC).

POLICY ON GUARANTEES (GOVERNMENT SUPPORT)

- To limit the issuance of guarantees;
- Public entities to borrow on strength of balance sheet;
- Use guarantees to support restructuring objectives and infrastructure development program;
- Meeting international agreement obligations;
- Levying guarantee fees to equalise the benefits on borrowing cost.

POLICY GUIDELINES

- ***Guarantees are only issued where:***
  - Appropriate risk management procedures exist;
  - Legislative requirements have been met;
  - Legal advice has been sought;
  - Time limit to the instrument;
  - Termination clause;
  - Maximum financial limits on claims;
  - There is a demonstrable need for government to accept such risks.

MANDATE OF THE FISCAL LIABILITIES COMMITTEE (FLC)

"Optimum management of CLs through"

- Risk assessment of the counterparties' credit quality and advise Minister accordingly;
- Monitor concentration in portfolio;
- Adopt a limit for total liabilities, set conditions and monitor adherence;
- Monitor performance against benchmark of total net debt, provisions and contingent liabilities as a percentage of GDP;

MANDATE - continued

- Advise Minister on approaches/policies;
- Consider applications and make appropriate recommendations;
- Determine appropriate fees and rules for non-payment;
- Consider legal implications;
- Monitor utilisation of guarantees and adherence to conditions;
- To provide oversight on the implementation of the contingent liability policy of the National Treasury;

MANDATE - continued

- Manage the CLs emanating from PPPs;
- Have a holistic view of all CLs;
- Satisfy itself of adequate systems in place;
- To monitor and report claims against state due to non-payment by counterparties and to adopt rules to deal with non-payment; and
- Consider the introduction of a funded contingency reserve account.

REVIEW AND MONITORING PROCESS FOR THE ISSUANCE OF GUARANTEES

ISSUANCE AND MONITORING PROCESS

- SOC establishes business case for guarantee to executive authorities, who if approves, submits the proposal documents to the FLC for review and recommendation to the Minister;

- FLC meetings are held quarterly with special meetings convened when required.

- FLC makes recommendations to the Minister to approve or to concur with the issuance of a guarantee;

- A memorandum with relevant details including the proposal document and recommendation is forwarded to the Minister;

ISSUANCE AND MONITORING PROCESS

- If Minister approves or concurs, a letter based on the outcome of the meeting, including conditions, is sent to the SOC as well as to the executive authorities;

- All guarantees are captured on a guarantees register kept by ALM;

- The register, which includes conditions to which guarantors must adhere, is subjected to verification and audit process to ensure accuracy;

- SOC's and government departments must submit guarantee information, including utilisation to the ALM division quarterly;

ISSUANCE AND MONITORING PROCESS

For the quarterly FLC meeting, the following reports are prepared…

- Report on monitoring of adherence to conditions;
- Report on the quality and level of government's exposure from the guarantee portfolio;
- Report on impact of individual requests on the total guarantee portfolio; and
- Performance against the target sustainability benchmark.

MANAGEMENT OF CONTINGENT LIABILITIES

RISK ASSESSMENT OF CONTINGENT LIABILITIES

Business Risks	Financial Risks
Industry Prospects - Operating Environment - Regulatory Framework Corporate Governance - Adherence to PFMA - Management Quality Market Position - Diversification - Size	Profitability - Cost to income ratio - Net profit margin - EBITDA margin Capital structure - Debt to assets - Debt to equity Cash flow adequacy - Funds from operations/Debt - Interest cover Liquidity ratios - Cash ratio - Quick ratio - Current ratio

Source: National Treasury

RISK RATING METHODOLOGY

- A risk rating methodology is applied to the different indicators for each SOC
- The ratings of are aggregated to determine a risk rating for each of the SOCs
- The ratings of the different SOCs are consolidated to determine a consolidated rating for the portfolio.

GUARANTEE EXPOSURE FOR 2012/13

- Issued guarantees currently at R471.9 billion
- Exposure, representing utilised guarantees at R179.4 billion
- Net debt, provision plus contingent liabilities, including on balance sheet implicit CL at 51.4 per cent of GDP
- Projected to peak at 53.3 per cent in 2014/15

Source: National Treasury

CONCLUSION

- Government assistance used to support infrastructure development program
- Fiscal Liabilities Committee used for evaluation and monitoring of CLs
- Credit risk policy and methodology for managing CLs
- Analysis on all counterparties to determine value and quality of exposure
- Exposure kept at sustainable levels

THANK YOU