Treasury Department

Introduction

The Treasury Department has the responsibility to maintain an effective accounting methodology and relevant accounting systems across Government; monitor and effect disbursements on behalf of line ministries and departments; oversee Government's cash flow position; and raise the necessary finances to service the government's obligations and commitments.

In order to fulfil its mission statement, the Department is split into two main directorates, namely the Debt Management and the Government Accounts Directorates.

Debt Management Directorate

Role and function

Established in December 2006, the Directorate is responsible for the operational dimensions of debt and cash management for the central government and for providing specified funding requirements as authorised by Parliament.

The principal objective of the Directorate in its debt management activity is to raise funds as well as carry out other financial transactions in such a way as to ensure that:

- the central government borrowing programme (short and long term) is financed prudently and cost effectively consistent with an acceptable level of risk;
- the annual debt servicing costs are met at the lowest possible cost;
- the development of the domestic financial markets is given the necessary support; and
- the liquidity of government funds is adequate to meet Government's financial commitments/obligations as and when they fall due.

The organisational structure of the Directorate reflects international standards. In line with this practice, it is divided into a Front, Middle and Back Office to ensure a clear division of responsibilities.

The Front office executes government debt policy regarding the issuance of government securities, the Middle office undertakes market research and analysis, while the Back office deals with registration and administration and settlements of central government debt.

Until now, in order to meet the borrowing requirements, the Government's policy has been that of relying, almost exclusively, on issuing euro-denominated stocks in the domestic market, rather than raising funds on the international markets.

Furthermore, as part of its cash management activity to finance any temporary shortfall in government revenue, the Treasury conducts weekly auctions for the issue of Treasury bills. These serve as temporary borrowing tools and usually carry a tenor of: 28 days; 91 days; 182 days; 273 days; and 364 days.

The Government of Malta's debt portfolio also includes foreign loans, set up as bilateral agreements with foreign governments and international institutions.

International Institutions

Credit Rating Agencies

In July 2010, the Directorate participated, as in previous years, in a meeting held at the Ministry of Finance with Standard and Poor's, during which debt management matters were discussed. As the credit ratings assigned to Malta bear a direct influence on the interest rate charged on loans raised from international markets, the Directorate assigns significant importance to its interaction with such agencies.

International Monetary Fund

Moreover, the Directorate gave also its inputs towards the Article IV consultation process carried out by the International Monetary Fund's (IMF) mission which visited Malta during November 2010. The IMF Staff Report for the 2010 Article IV Consultation was eventually completed on 6 January 2011 and released on 24 January 2011.

Economic and Financial Committee (EFC)

During the year 2010, the Directorate continued to attend meetings of the Economic and Financial Committee (EFC) Sub-committee on EU Government Bills and Bonds Markets whose main objectives are to promote further the integration and achieve a better functioning of the EU government bond markets.

The sub-committee deals also with other important issues of public debt management and holds regular discussions mostly related to the technical aspects of debt management with a view to identifying key issues and risks. The sub-committee promotes the sharing of experiences among the 27 EU Member States and supports Member States in identifying and implementing best practice in government debt management.

Three meetings were held during the course of the year which focused mainly on the implications of larger government financing needs by EU Member States and market volatility.

Turkish Cypriot Community Study Visit to Malta

In May 2010, the Directorate participated in a study visit programme organised for the Turkish Cypriot Community by the European Commission under the Technical Assistance and Information Exchange (TAIEX) initiative.

The Directorate delivered a presentation about the administrative set-up, development and functions of the Debt Management Directorate which was followed by a practical demonstration on the conduct of weekly auction of Treasury Bills. During this session, the Turkish Cypriot Community was given the opportunity to gain first hand experience of the administrative procedures adopted in the Treasury Bills auctioning process.

Financial Markets Committee

The Debt Management Directorate was invited to participate in the Financial Markets Committee (FMC) organised by the Central Bank of Malta for treasury officials of the local credit institutions.

The Debt Management Directorate attended twice (in April and October), with the intention of increasing exposure and explaining the various duties taken care of by the Directorate whilst getting feedback by the private sector on market conditions and investor sentiment.

Other Institutions

During the course of the year, the Directorate together with the Central Bank of Malta held meetings with foreign banking institutions, during which emerging issues in the global and domestic Sovereign Bond and Bills Markets were discussed. In April, the Directorate took part in a meeting of the DG – ECFIN held at the Ministry of Finance.

DEBT MANAGEMENT OPERATIONS

Treasury Bills

The statutory basis for the issuance of Treasury bills is set out under Malta Treasury Bills Act, Cap.133. The maximum amount of outstanding Treasury bills is established by Parliamentary Resolution. In 2002, the maximum amount was set at Lm300 million, equivalent to €698.80 million.

The issuance of Treasury bills serves a dual role - primarily to cover for temporary revenue shortfalls incurred by the Government and secondly, to maintain liquidity in the domestic Treasury bills market.

Treasury bills are offered by public auction on a weekly basis, normally on Tuesday of the auction week and are issued in denominations of €1,000 with tenors ranging from 28 days, 91 days, 182 days, 273 days and 364 days. A mix of different tenors can be offered in any auction.

As from 1 April 2007, Treasury bills were dematerialised and were admitted to listing and trading on the Malta Stock Exchange. Yields on Treasury bills started to be computed on an 'Actual/360 days' basis.

Chart 1 illustrates the maturity profile of the outstanding balance of Treasury bills as at end of 2010. The outstanding stock balance of €377.76 million at end of 2010 represents a decrease of €96.38 million over the amount outstanding at end of 2009.

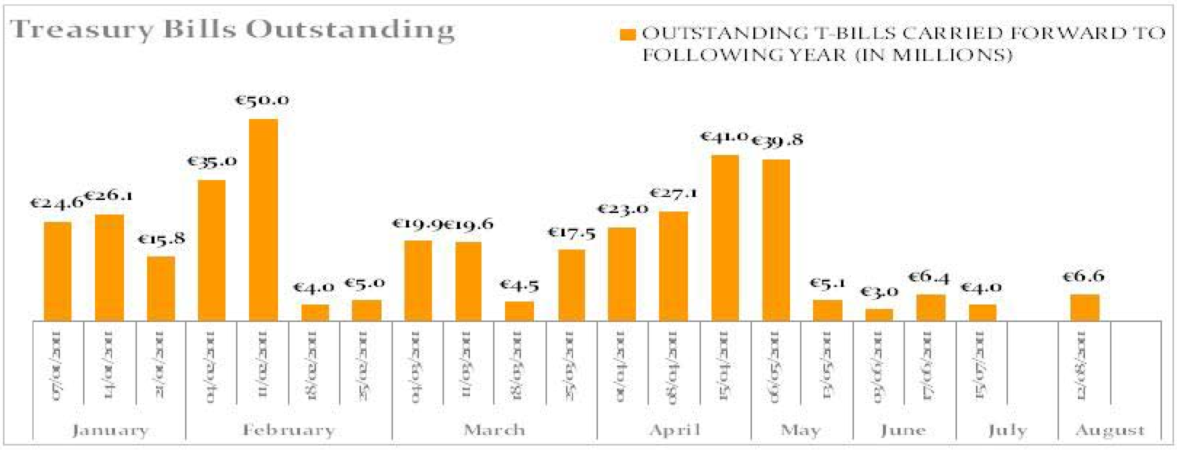


Chart 1 - Level of T-bill stocks in market hands as at end 2010

Treasury Bills Issuance Programme

The issuances focused mainly on the 91-day and the 182-day tenor (representing 42.5% and 34.3% of total volume issued respectively). The primary market yields for the 91-day T-bill fluctuated between a maximum of 1.319% (on 8 January 2010) and a minimum of 0.531% (on 28 May 2010).

The primary market yield of the 182-day T-bill peaked at 1.399% (on 8 January 2010) and was lowest at 0.667% (on 28 May 2010). Such interest rates for temporary borrowing are determined by the money market which in turn is influenced by the repo market rates.

The total offers accepted by the Treasury throughout the year 2010 amounted to €1,245.19 million, categorised by tenor and volume as shown in Table 1 below:

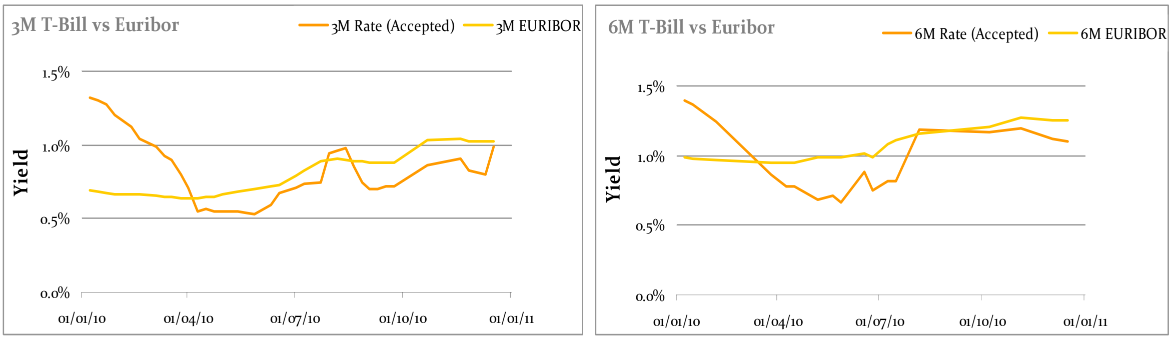
Table 1 – Gross Issuance of T-Bills in 2010

Tenor (days)		Share of total Issuance (%)	Nominal Amount (€ 000)	Weighted Average Yield (%)
28		9.4	117,000	0.76
91		42.5	528,910	0.83
182		34.3	427,254	1.01
273		13.8	172,025	0.90
365		-	-	-

The cost of borrowing in respect of T-Bills issued during 2010 amounted to €4.51 million, equal to a weighted average yield of 0.926% and a weighted average maturity of 141.5 days.

Chart 2 shows the weighted average cost of borrowing on 3-month and 6-month T-Bills vis-à-vis the corresponding Euribor throughout the year. On average over the year, the yields of accepted Treasury bills for three month and six month tenor outperformed the average of the respective Euribor rates.

Chart 2 – 3 Month and 6 Month T-Bill vs Euribor



Redemptions on Maturity

Throughout the year, the Treasury redeemed €1,341.56 million worth of Treasury bills, carrying a cost of borrowing equal to €6.03 million equivalent to a weighted average yield of 1.221%.

Monthly movements in gross issuance and redemptions of Treasury bills show an increase in net issuance during the first six months of the year. This trend was however reversed in the second half of the year with the result that the total outstanding level of Treasury Bills decreased by €96.38 million by the end of the year.

Malta Government Stocks

Authority to raise loans on behalf of the central government is set out in an annual budget law which authorises the Minister of Finance to raise loans for an established amount during the financial year by the issuing of securities and provides also the main purposes for which Government can apply such borrowing.

For the financial year 2010, the Budget Measures Implementation Act (Act No I of 2010) established a maximum borrowing limit of €550 million in Malta Government Stock. The issuance programme was applied for the purpose of:
- Financing the Central Government borrowing requirements for 2010;
- Redeeming Malta Government Stocks (MGSs) maturing during the year; and
- Effecting changes in Central Government debt portfolio as and when required in line with Government's debt management policies.

Issuance of MGS

In line with the strategy announced at the beginning of the year, issuance in 2010 focused mainly on the fixed-rate euro denominated stocks with maturity horizon biased towards the longer end of the curve. As in recent years, the Directorate continued to issue fungible MGS with the aim to contribute towards further deepening in the liquidity of current benchmark issues.

In each issue the price offered for members of the public is usually announced three days in advance of the opening of the applications and the results of the bids by auction are announced within two hours from closing time of auction.

The total sum raised through the MGS issuance programme during 2010 reached €547.96 million. There were four MGS issues during the year, having a medium to long term maturity horizon as shown in Table 2 below.

All the issues of Malta Government Stocks in the primary market attracted strong demand both from members of the public as well as from financial institutions. The November issue was over-subscribed by members of the public and was closed before the announced closing dates as there was no balance available to be auctioned through the bidding system. The last time an MGS issue was oversubscribed by members of the public dates back to November 2004.

Table 2 - MGS Issued in 2010

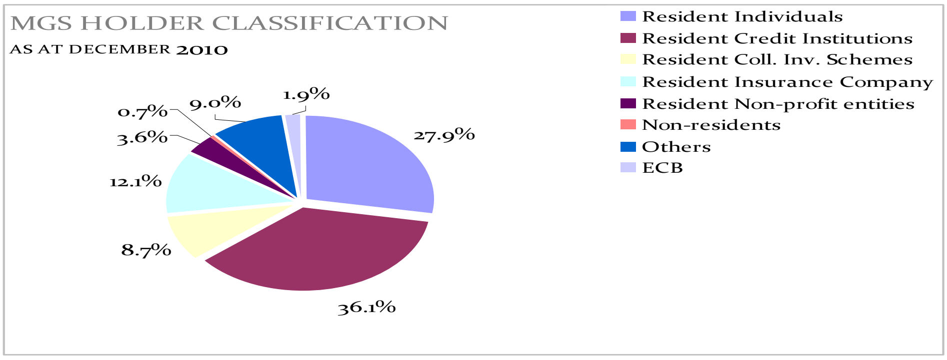
Issuance	Issuance Strategy (€ Millions)				Selling Mode		Bid-to-cover ratio
	5-year	10-year	20-year	3-year FRN	Retail	Wholesale	
February	67.22	75.33		7.25	33%	67%	2.49
May	18.11	38.30	93.73		46%	54%	2.32
August	40.12		109.13		51%	49%	2.18
November	6.10		92.68		100%	-	1.53

In addition to the above issuances, a placement of one MGS amounting to €0.43 million towards the partial settlement of ex-church property was issued in June 2010.

Distribution by investor type

Securities on the market are distributed among a diverse range of investors from private investors to institutions of different groups. As at end of December 2010, securities were principally held by financial institutions and resident individuals (holding 36.1% and 27.9% respectively). Chart 3 below explains the distribution of all MGS securities on the market.

Chart 3 – Distribution of securities by investor type



Loan Facility Agreement (Hellenic Republic)

Pursuant to a decision taken by the Council of EU in May 2010, the Government entered into a loan agreement with the Hellenic Republic to lend €74.54 million in tranches over a period of three years. Following discussions at ministerial level, the Directorate prepared draft legislation for vetting by the Office of the Attorney General. Subsequently, an act entitled Government Borrowing and Granting of Loans to the Hellenic Republic Act 2010 (ACT III of 2010) was enacted by Parliament in May, 2010.

Under the said Act, the Treasury raised a further €30 million by issuing a 3-Year Floating Rate MGS tied to the 6-month Euribor plus a spread of 45bps. The issuance of this security was intended for the financial institutions and was fully subscribed.

During 2010, two tranches amounting to €19.77 million were disbursed to the Hellenic Republic under the above-mentioned agreement.

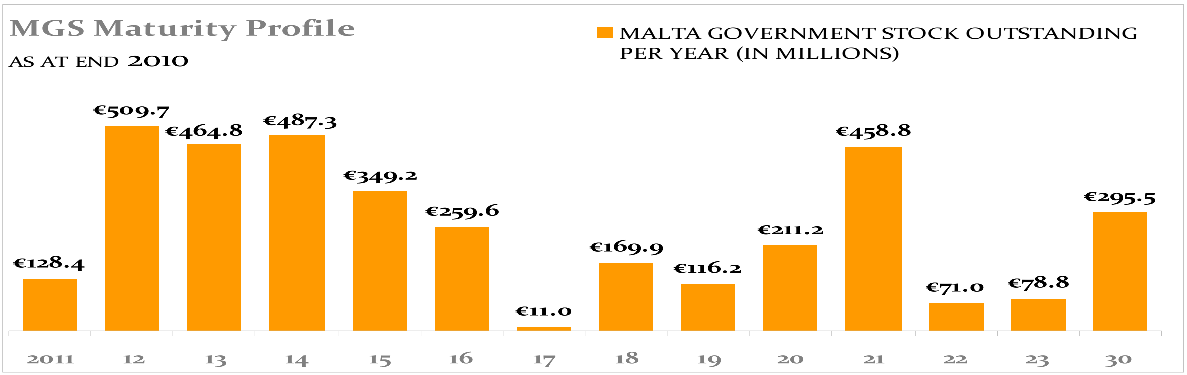
Debt Servicing

During the year, four MGS with a nominal value of €191.11 million were redeemed. The outstanding nominal value of MGS as at year end reached € 3,611.46 million.

Chart 4 indicates that the distribution of the MGSs maturity profile lies skewed to the left, to the extent that 40.47% (compared with 44.18% at end of 2009) of total outstanding debt matures during the period 2012-2014.

In order to continue improving in this direction and obtain a relatively smooth redemption profile, strategic measures by the issuance of stocks in the 9-year to 20-year maturity bucket have been initiated. As a result of such strategic measures, the weighted average maturity (WAM) of MGSs has now reached nearly seven years compared with nearly six years for end of year 2009.

Chart 4 - Outstanding MGS Profile as at 31 December 2010



Cost of Borrowing

The Directorate services the half-yearly interest payments to existing stockholders which during 2010 amounted to €186.21 million. Payments of interest throughout the year were spread as illustrated in Chart 5 below:

Chart 5 - Monthly Distribution of Interest Payments on MGS

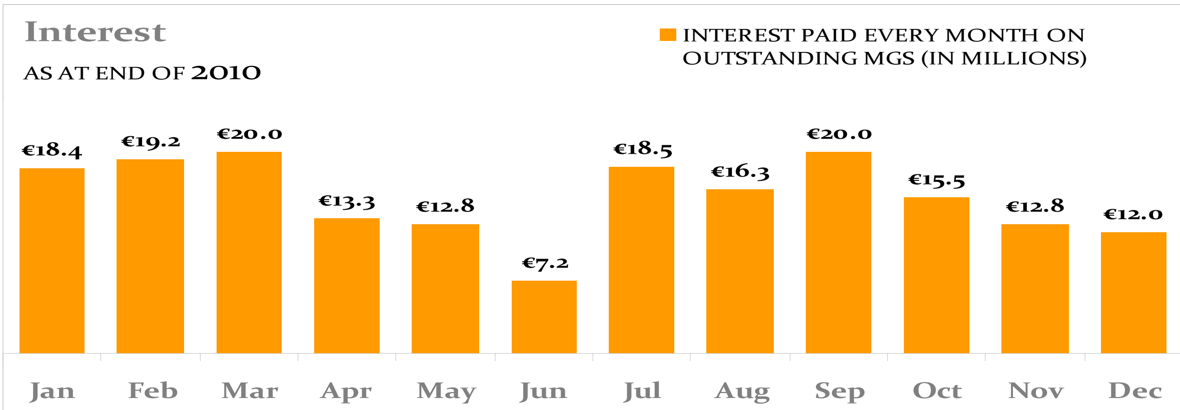
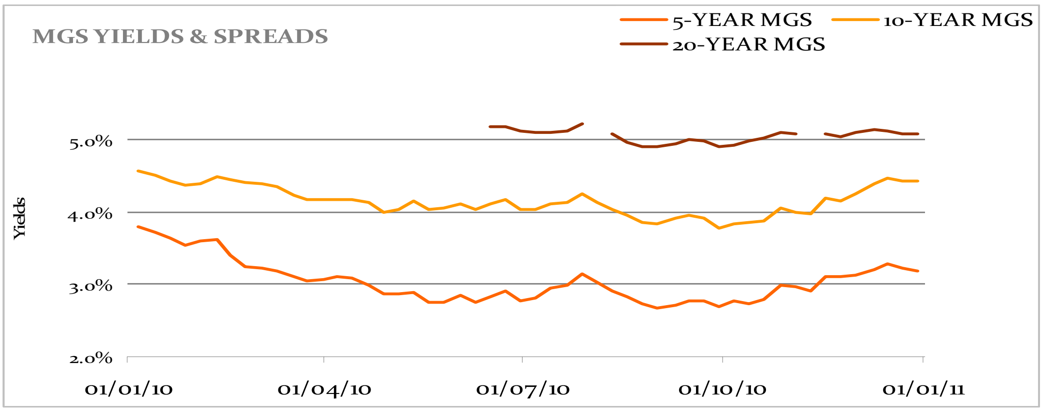


Chart 6 shows that during 2010 the spreads between the 5-year and 10-year maturity period fluctuated between a high of 130 basis points (26 May) and a low of 79 basis points at the beginning of the year. The average spread for the entire year stood at 112 basis points.

The spread for the 10-year to 20-year maturity remained stable from mid-June until end of October with values around 104 basis points, and then flattened in the last two months.

Chart 6 – 5yr, 10yr & 20yr MGS yield performance in 2010



Foreign Loans

Bilateral loans with foreign entities are specifically undertaken to finance large capital projects. A total of €13.12 million was repaid throughout the year according to the repayment schedule, resulting in an end-of-year balance of €87.70 million.

Staff Training and Development

The Directorate continued to invest in the training of its human resources, both through in-house programmes and through external courses organised by local and foreign institutions. During 2010, a number of initiatives were undertaken and various opportunities were offered to its staff to attend training courses, seminars and annual conferences organised by institutions both locally and abroad. These included:

- Derivatives Course, hosted by Barclays Capital;
- Pan-Commonwealth Workshop on Domestic Debt Management, hosted by Commonwealth;
- Managing with Leadership, organised by the CDRT; and
- Anti Fraud and Corruption Train the Trainers Course organised by the Internal Audit Directorate.

Support Services

As in previous years, the Directorate continued to offer guidance and provide the necessary service to the heirs of deceased stockholders so that the heirs can have any inherited stocks transferred in their name by a procedure initiated through the heirs' own legal adviser.

During the course of the year, the Directorate received 373 new claims from the heirs' legal advisers requesting the transmission of MGS from deceased stockholders to their clients. The Directorate settled 269 claims, out of which 214 were lodged during 2010 and 55 related to claims which were pending from previous years.

Online Services

During the year, the Directorate contributed towards the revamping of the Debt Management section within the Treasury's website, making available upgraded and new information in an effort to better meet the needs of the clients. Among other things these include:

- the publication of Treasury bills weekly auction results;
- weekly bid analysis of Treasury bills;
- tender forms for Treasury bills;
- Malta Government Stocks auction results;
- monthly issuance calendar for Treasury bills;
- the yearly indicative issuance calendar of Malta Government Securities.

Such new section was launched on 1 February 2011. Moreover, new guidelines intended for the heirs of deceased stockholders in respect of *causa mortis* claims will be launched later on during 2011.