DEBT MANAGEMENT DIRECTORATE

The Debt Management Directorate (DMD) was established within the Treasury department in December 2006 with responsibilities for 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 and cash management activities is to raise funds to meet the Government's financing needs as well as carry out other financial transactions such that central government borrowing programme is financed prudently and cost effectively to ensure that:

- The costs of meeting Government's financing needs are minimised over the long term taking into account an acceptable level of risk;
- The development of the domestic financial markets is given the necessary support; and
- The liquidity of government funds is adequate to meet government's payment obligations as and when they fall due.

I. Organisation and resources

The DMD is organized along functional lines under three main areas: a Front, Middle and Back Office to ensure a clear division of responsibilities according to international best practices.

The Front office co-ordinates and manages the activities of the directorate related to the issuance of Government securities; the Middle office undertakes market research and risk analysis activities; whilst the Back office is responsible for the servicing, settlements and accounting of central government's debt and cash management transactions.

II. Legal framework for borrowing

The statutory basis for central government borrowing is set out under the following primary and subsidiary legislation:

- Malta Treasury Bills Act, Cap.133 *(relating to the issue of short-term borrowing up to 12 months maximum maturity*. The maximum amount of outstanding Treasury bills is established by Parliamentary Resolution. In 2002, the maximum amount was set at €698.8 million;
- Malta Treasury Bills (Dematerialisation) Regulations, 2007;
- Local Loans (Registered Stock and Securities) Ordinance, Cap.161 *(relating to terms and conditions applicable to loans authorised to be raised locally by the issue of stock in Malta);*
- Local Loans (Registered Stock) Regulations, S.L.161.01;
- Development Loan Act, Cap.229 *(in respect of bilateral loans raised outside Malta);*
- An annual budget law that authorises the Minister of Finance to raise loans on behalf of the government 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.

III. Financing Instruments and Operations used in Debt and Cash management

Until now, the Government's policy to meet its financing needs has been that of relying almost exclusively on issuing euro-denominated financing instruments in the domestic market rather than raising funds on the international financial markets.

The main financing instruments used to finance the central government funding requirements were Treasury bills (T-bills), being of maturity of 12 months or less, and Malta Government Stocks (MGSs).

The Treasury carried out its **cash management activities** by conducting regular public auctions of Treasury bills (T-bills) on a weekly basis. T-bills are primarily issued to cover for temporary liquidity needs arising due to timing mismatches between revenue and expenditure flows. Hence they contribute to smooth the implementation of the operational targets of fiscal policy and public debt management. Moreover, such issuances also serve to maintain activity and development of the domestic Treasury bills market. T-bills issued to investors through such auctions are listed and traded on the Malta Stock Exchange.

The conventional fixed-rate MGS remained the Treasury's primary financial instrument by which it funded the **long-term borrowing** programme for 2015. The fixed-rate MGS issued consisted of maturities between five (5) - and twenty-five (25) years. Treasury also continued to offer Floating-Rate MGSs (FRNs) linked to the six-month Euribor through the auction system. All MGSs are listed and traded on the Malta Stock Exchange.

Malta Government Stock Financing Operations in 2015

In terms of '*The Budget Measures Implementation Act*' (*Act No XIII of 2015*), the total amount of MGS issuances for 2015 was set not to exceed €500 million.

The funding programme was mainly applied for the purpose of financing:

- the redemption of six (6) MGSs amounting to €349.2 million;
- an estimated budget deficit of Central Government of €148.6 million; and
- effect changes in Central Government's debt portfolio, in line with Government's debt management policies.

I. Issuance Strategy

The issuance strategy for 2015 maintained the main features adopted in the year 2014. The four MGS issuances during the year 2015 were more or less evenly spread throughout the year, raising a total sum of €473.2 million. A little over 50% of the MGS issuance programme was covered by the end of June. As detailed in the Indicative Issuance Calendar published on 7th January 2015, the issuance strategy focused mainly on fixed-rate, euro-denominated stocks with maturity horizons spanning in the short- and long-term. The Treasury issued two new medium to long-term, fixed-rate bonds giving the opportunity to investors to extend into long-dated maturities sporting a relatively attractive coupon in an extremely low interest rate environment. The new fixed rate MGSs issued were:

- 2.30% MGS 2029 (II); and
- 3.00% MGS 2040 (I);

Moreover, the directorate continued to support the development of the domestic debt market by issuing a new floating-rate stock (FRNs) linked to the 6-month EURIBOR, primarily intended for institutional investors. By the end of 2015, the ratio of floating-rate notes to the total portfolio of outstanding MGS remained in the 5.0% region or similar to the levels prevailing at the end of the year 2014.

Table 1 illustrates the type and maturity bucket of MGS in each issuance.

Table 1 – MGS Issuances in 2015				
	Issuance Strategy *(€ million)*			
Issuance month	Short-Term	Long-Term	FRN	**Total**
March	6.0	162.3		168.3
June	73.9	16.1		90.0
October	52.5	127.4		179.9
November			35.0	35.0
TOTAL	**132.4**	**305.8**	**35.0**	**473.2**

In addition to the above issuances, an MGS amounting to €2.01 million was issued in partial settlement of transfer of ex-Church property to the government in terms of the Holy See and Malta Government Agreement of 1991.

II. Strong Demand for MGS issues

The domestic market continued to absorb comfortably the levels of issuances of MGS. All four issues were fully subscribed and where applicable each time the Treasury exercised the over-allotment option. The results are shown in **Table 2**. The first issuance for 2015 (March) was characterised by the extraordinary participation from the retail sector, mostly individual investors. The issue was fully subscribed by retail investors attracting a strong bid-to-cover of 3.7x. Since Treasury's allocation policy gives priority to retail investors, the auction window planned for institutional investors was called off. Due to the overwhelming response the allocation of MGS to retail investors who applied for an amount exceeding €10,000 (nominal) had to be scaled down (allotting the first €10,000 [nominal] in full plus a further 12% [rounded up to the nearest €100] of the remaining unallocated balance).

In order to cater for the demand by institutional investors, the directorate launched two issues (June and November) by auction only specifically targeted for institutional investors as well as another combined issue offered to both retail and institutional investors in October 2015. As can be seen from the bid-to-cover ratios (Table 2 below) there was strong participation from institutional investors in all the three issues.

Table 2 – MGS Participation			
Issuance month	**Amount offered +over-allotment *(€ Millions)***	**Total Participation *(€ Millions)***	**Bid-to-Cover**
March*	120+60	443.1	3.7
June **	50+40	193.6	3.9
October	120+60	231.4	1.9
November **	35+0	59.3	1.7
TOTAL	**485.0**	**927.4**	

** Issue was over-subscribed by retail investors.*

*** Issues (by auction) targeted for institutional investors.*

Table 3 illustrates the ratio allotted by auction to total applications accepted, and the ratio of bids accepted against bids received.

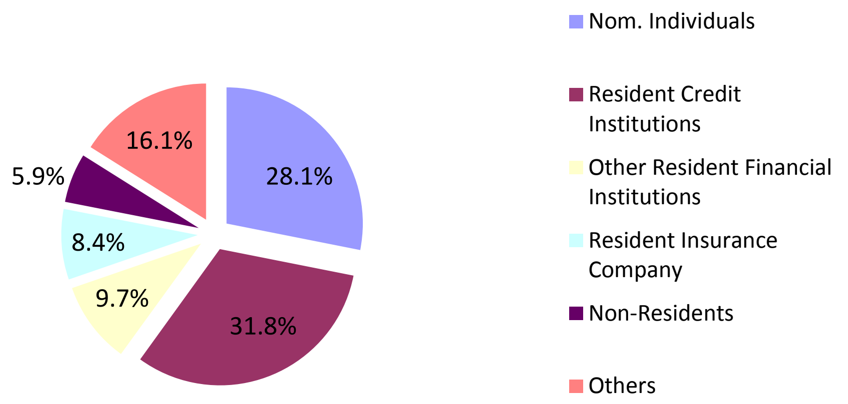
Table 3 – Demand vs Allotment of competitive bids by institutional investors

Issuance	Security Issued	Total Allotment € millions	Allotted by Auction € millions	bids as % of Total acceptance	bids accepted / total bids received
Mar	2% MGS 2020	6.0	n/a	n/a	n/a
	3% MGS 2040	162.3	n/a	n/a	n/a
	Total	**168.3**	**n/a**	**n/a**	**n/a**
Jun	2% MGS 2020	73.9	73.9	100.0%	49%
	2.3% MGS 2029	16.1	16.1	100.0%	36%
	Total	**90.0**	**90.0**	**100.0%**	**46%**
Oct	2% MGS 2020	52.5	51.2	97.5%	55%
	2.3% MGS 2029	127.4	39.2	30.8%	80%
	Total	**179.9**	**90.4**	**50.2%**	**64%**
Nov	FRN MGS 2019	35.0	35.0	100.0%	59%
	Total	**35.0**	**35.0**	**100.0%**	**59%**

III. MGS Holder Distribution by investor type

The distribution of MGS among the different types of investor categories is depicted in **Chart 1**. The two most significant holders of MGS are *resident nominal individuals* and *resident credit institutions*, with 28% and 32% respectively. *Resident insurance companies* held almost 9%, whilst *other resident financial institutions* held almost 10%. The level of *non-resident* holdings increased to almost 6%, (from almost 5% a year earlier). Holdings by other investors, principally resident entities not falling under the main categories, including non-profit entities, local councils and public non-market units collectively amounted to 16%.

Chart 1 – MGS Holder Distribution as at 31st December 2015

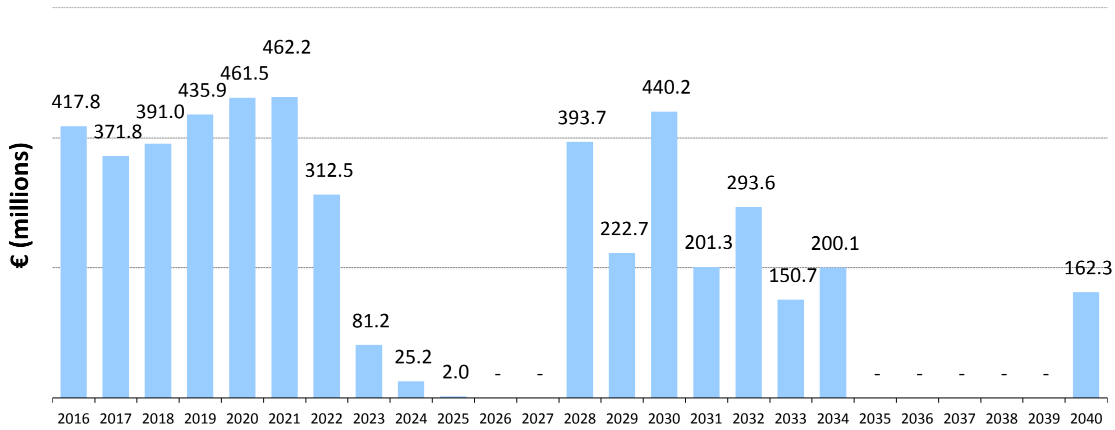


IV. Maturity Profile

The gross outstanding nominal value of MGS as at 31st December 2015 reached € 5,025.6 million, representing a 2.6% increase over the end-2014 balance. **Chart 2** illustrates the distribution of outstanding MGSs by year of maturity.

In the current low interest rate scenario where interest rates touched historical lows, the DMD deemed it suitable to issue longer dated bonds with a relatively attractive coupon intended for investors in search of bonds that yield a higher return and guarantees a stable income stream. Moreover, by locking in long term maturities, the directorate extended the maturity profile of the portfolio by a further five years (up to 2040). At the end of the year the weighted average maturity (WAM) stood at 8.7 years, compared to 8.6 years 12 months prior. The skewness has remained relatively stable with 32% of the portfolio maturing in the coming four years, a 1% increase over the position at the end of the year 2014.

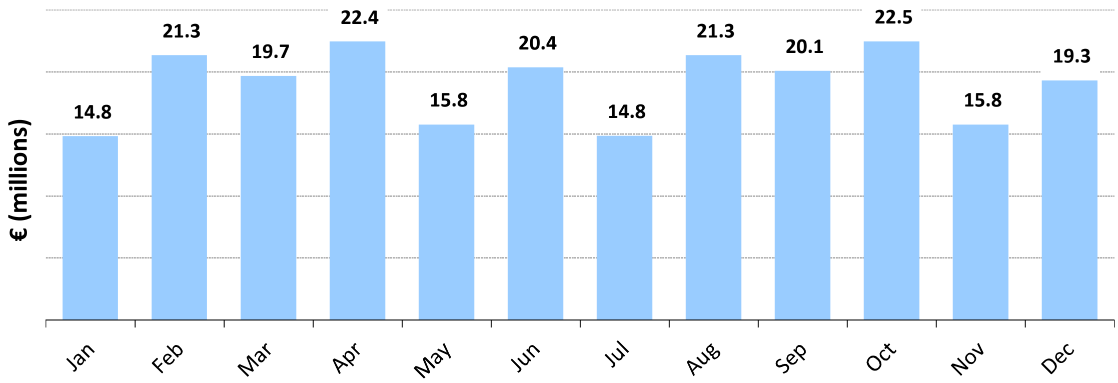
Chart 2 - Outstanding MGS Profile as at 31 December 2015



V. Cost of Borrowing

The interest payments on MGS in 2015 amounted to €228.2 million resulting in a 1.6% increase over interest paid in 2014. The distribution of monthly aggregate semi-annual coupon payments is depicted in **Chart 3**.

Chart 3 - Distribution of Monthly MGS Interest Payments – 2015



The MGS portfolio weighted average coupon (WAC) as at 31st December 2015 continued to decrease to 4.56% from 4.82% a year earlier. Given the low interest rate environment on a global level, the DMD could replace the high coupon-paying maturing stock with longer dated bonds paying a lower coupon, thus decreasing the WAC and extending WAM at the same time.

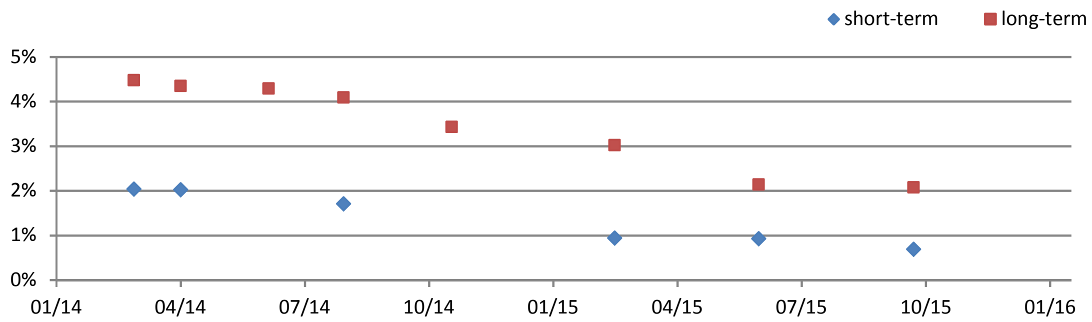
VI. Developments in the MGS Markets during 2015

The year 2015 was another year of unprecedented low interest-rates across the entire global economy, mostly within the EU. Despite the ECB keeping its main refinancing rate at 0.05%, introducing its own quantitative easing (QE) programme in the form of a Public Sector Purchases Programme (PSPP) and cutting the deposit facility rate into negative territory, the euro-area still experienced no significant jumps in inflation. These (together with other) forces continued exerting downward pressure on sovereign bond yields. In the year 2015 the spreads between the benchmark German Bund and most Euro sovereign bonds narrowed further.

This narrowing had an impact on the domestic capital market as well, where Malta Government Stocks reached the lowest yields on record so far. Such low yields provided the directorate with opportunities to borrow on the primary market at record low interest rates. On the other hand, this created some challenges in offering attractive coupons in both the short- & medium-term, especially to retail investors.

The yield of short- & long-term MGS (calculated as a weighted average of retail & wholesale) issued on the primary market in the past two years is plotted in **Chart 4.** The bar graph represents the maturity in year for each respective issuance. It is of particular interest to take note of the long-term yield falling from 4% to 3% in less than six months (08/14-02/15) when the maturity has in fact increased by 5 years. In the primary market, the 5-year yield has not risen above 1% in 2015.

Chart 4 –Primary Market Yields & Maturities Jan 2014- Dec 2015



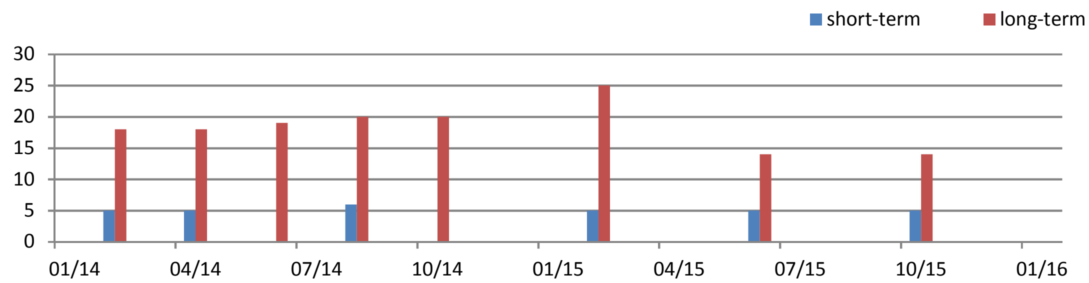


Table 4 shows the spreads that investors (both retail & wholesale) received over the interpolated German bund of identical maturity in primary issues of MGSs on the domestic market in 2014 & 2015. Both short- and long-term spreads decreased considerably, with the former practically halving in less than two years. Long-term spreads decreased by 83bps between April 2014 and October 2015, in line with the general trajectory of falling yields in European sovereign debt markets.

Table 4 – Spread Over Bund in Primary Market (Fixed Coupon MGS)					
Year	Issuance	Short term		Long term	
		Retail	Auction	Retail	Auction
2014	Mar	+141bps	+138bps	+213bps	-
	Apr	-	+133bps	-	+200bps
	Jun	-	-	+224bps	-
	Aug	+123bps	-	+215bps	-
	Oct	-	-	-	+185bps
2015	Mar	+99bps	-	+212bps	-
	Jun	-	+64bps	-	+93bps
	Oct	+73bps	+72bps	+122bps	+117bps

Source: Deutsche Bundesbank (www.bundesbank.de) & own calculations
Note: Minor revisions were carried out in the auction spreads for 2015 to achieve consistency in methodology adopted in previous years for the derivation of spreads.

Treasury Bills

The DMD also issued weekly Treasury bills to support its daily cash management activity given that Treasury bills is the only cash management instrument used in the cash management operations. As in previous years, in 2015 the directorate made extensive use of the instrument in order to rough tune the cash balance at CBM and smooth the fluctuations in the cash balance arising from the mismatch between the timing of receipts and payments. Contrary to the trend seen in recent years in 2015 the outstanding balance of T-bill at the end of the year increased by €81.6 million to reach €222.1 million. Nevertheless, the outstanding balance at the end of the year was €27.95 million less than the revised projections published in October 2015.

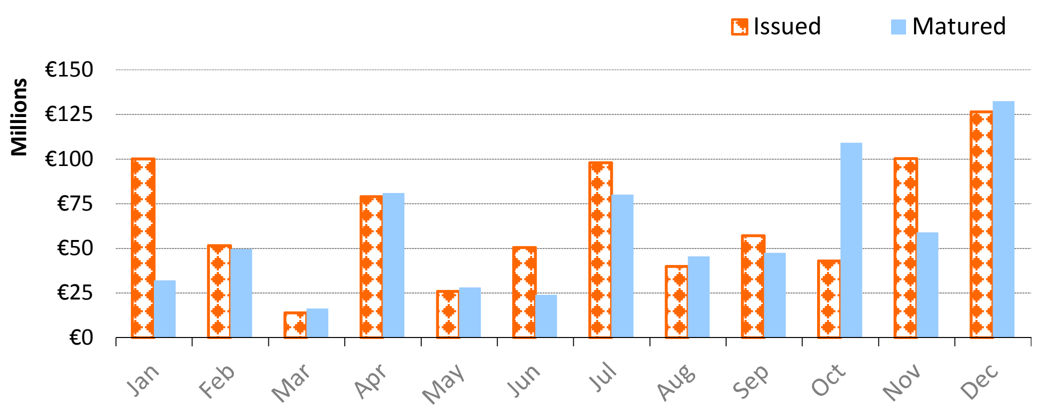
I. Issuance Strategy

The issuance strategy was designed around short-term financing needs (timing mismatches) offering a mix of tenors depending on market appetite and consistent with an acceptable level of risk. Throughout the year there was a strong market demand to buy Treasury bills which were offered through the auction process. A summary of the issuances and redemption in each tenor for the year are shown in Table 5. Following the historical trend, but in a more pronounced manner, the 91-day bill was the most commonly used tenor in 2015, followed by the 182-day T-bill, with the former making 60% of total issuance, and the latter representing 27% (46% & 38% respectively in 2014). The remaining three tenors correspond to about 13% of total issuance. The weighted-average maturity (WAM) of T-bills issued in 2015 stood at 124 days (compared to 118 days in 2014).

Table 5 - T-Bills issued by tenor in 2015				
Tenor	Issued *(€ million)*	% of Total	Redeemed *(€ million)*	% of Total
28	51.4	7%	57.4	8%
91	468.0	60%	427.3	61%
182	215.6	27%	216.7	31%
273	43.1	5%	3.0	0%
364	8.0	1%	0.0	0%
Total Issuance	**€786.0**	**100%**	**704.4**	**100%**

Chart 5 below shows gross issuance and redemption on a monthly basis. Net issuance was positive in the first three quarters (+ €112.2 million) with the net increase being partially offset in quarter four (- €30.6 million)

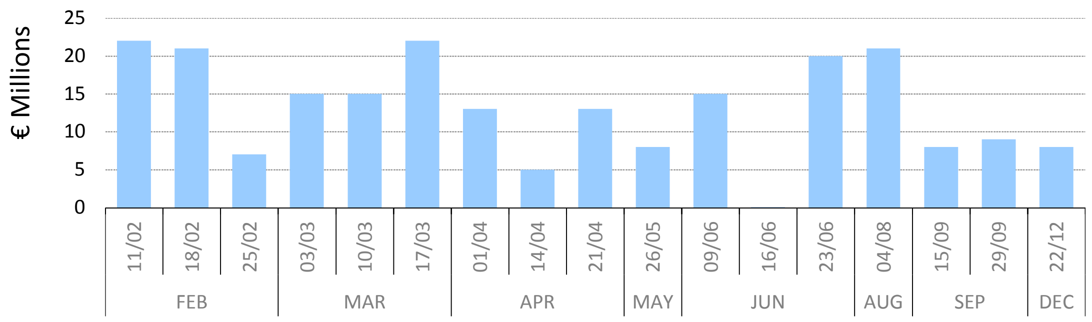
Chart 5 - T-Bills issued and redeemed per month in 2015



II. Redemption Profile

At the end of the year 2015 the outstanding nominal balance of treasury bills amounted to €220.1 million. This was entirely held by resident credit institutions. **Chart 6** shows how this balance will be redeemed throughout 2016.

Chart 6 - Outstanding Treasury Bills as at end 2015

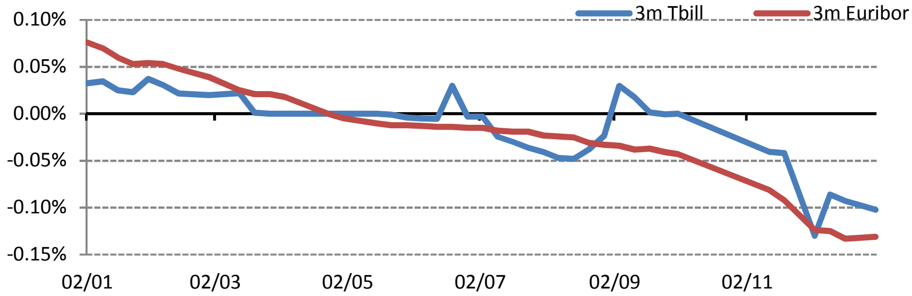


III. Yields & cost of borrowing

For the first time on record, the DMD raised finance from the money market at negative interest rates in 2015. This implies that bidders are willing to pay, rather than receive interest, to lend their money to the government.

As can be seen in **Chart 7** the primary market yield on the domestic three-month Treasury bills mirrored the movements in the three-month Euribor **.** Even though domestic rates were more volatile, as from the start of the year there was clear downward pressure on the 3-month rate, peaking at 0.037% on the 30th January and reaching a minimum of -0.130% on the 3rd of December. The 3-month T-bill rate and the 3-month Euribor intersected on several occasions during the course of the year.

Chart 7 – 3-month Euribor vs. Accepted 3-month T-bill rates



Source: European Banking Federation (www.euribor-ebf.eu) & own calculations.

The overall net effect on the interest expense on new T-bills issued in 2015 was negative €0.05 million (+ €1.3 million in 2014). Interest paid on T-bills maturing in 2015 was equal to €0.1 million compared to €1.9 million a year earlier. The latter amount excludes interest received by Treasury amounting to €0.08 million on T-bills issued during 2015 at negative rates.

Gross issuance of T-bills was reduced by 14% YoY (€786.0 million vs €910.2 million). With a larger portion of issuance focused on 91- & 182- day, the WAM was extended further to 124 days (118 in 2014). Without taking into account the income from negative interest rates (which for accounting purposes is accounted for separately), the low interest rate environment contributed to a decrease in the short term borrowing cost by €1.2 million over last year. The entire portfolio's weighted average yield on accepted bids was -0.019%.

Table 6 below shows the maximum and minimum accepted rates together with the weighted average rate for the most frequently issued tenors.

Table 6 - T-Bills borrowing rates

Tenor	Max	Date	Min	Date	WAR
1 month	0.020%	30-Jan-2015	-0.030%	12-Nov-2015	-0.012%
3 months	0.037%	30-Jan-2015	-0.130%	03-Dec-2015	-0.020%
6 months	0.055%	16-Jan-2015	-0.100%	10-Dec-2015	-0.003%

Foreign Loans

Bilateral loans with foreign official creditors were specifically undertaken by Government to finance large capital projects. During the year 2015, €10.6 million were repaid in accordance with the established repayment schedules, resulting in an end-of year outstanding balance of €29.8 million. No new loans were undertaken.

Interest costs incurred during 2015 to service these loans amounted to €1.8 million. The majority of Government's bilateral loan agreements are denominated in euro as shown in **Table 7**, hence making any exchange rate risk insignificant.

Table 7 - Foreign loans outstanding by currency as at 31/12/2015				
	Euro	USD	CAD	Total
Amount (€ Millions)	29.63	0.00	0.14	29.77
%	99.53%	0.00%	0.47%	100.00%

Exchange rates as at 31/12/2015.
Source: Central Bank of Malta (www.centralbankmalta.org) & own calculations.

Expert Advice from ComSec on the proposed new Government Debt legislation.

During the year the Treasury continued to work with ComSec on the Government Borrowing and Public Debt Management Act . The final draft of the proposed legislation was submitted for comments to the Ministry of Finance in December 2015.

The scope of this new piece of legislation is to replace the different pieces of legislation enacted long time ago and which currently govern the borrowing by the Maltese government. Apart from bringing the different pieces of borrowing legislations under one act it shall introduce the concept of management of public debt consistent with international best practice in debt management.

Settlement Cycle of Government Securities in the Primary Market moved to T+2

Following the migration to the T+2 settlement cycle in the secondary market for government securities which occurred on 6th October 2014, in 2015 the directorate extended the T+2 settlement period to the primary market. After consultations were held with key stakeholders, the settlement period of Malta Government Stocks and Treasury bills allotted through the auction system was harmonized with that of the secondary market on a T+2 basis on 1st January 2015 and 1st October 2015 respectively. In this respect, the settlement period for all government securities both in the primary and secondary market was harmonized to T+2 and brought in line with most Euro area member states.

The Repayment of Capital by Direct Credit Initiative

In the 2015 the directorate offered the opportunity (on a voluntary basis) to all investors of Malta Government Stocks to have the repayment of principal on maturity paid directly into the bank account nominated for the receipt of the interest of the Stock. Around one third of all holders of Malta Government Stocks subscribed to this initiative which entered into force with effect from 1st October 2015.

The EU Emissions Trading System (EU ETS)

In fulfilling its mandate as the auctioneer for Malta, the directorate within the Treasury Department participated in the auctions conducted by the European Energy Exchange (EEX). Under the EU Emissions Trading System Malta's share of auctioned allowances for the year 2015 was 814,000 allowances of which 733,000 were in respect of EUAs (stationery installations) and 81,000 in respect of EUAAs (aviation).

In 2015, 142 EUA and 9 EUAA auctions were held (usually on Monday, Tuesday and Thursday of every week). Malta's 2015 share of revenue generated from these auctions amounted to €6.2 million, representing €5.6 million from EUAs and €0.6 million from EUAAs.

Relations with other institutions

I. International Monetary Fund

The directorate gave its input towards the annual Article IV consultation process carried out by the International Monetary Fund (IMF). To this effect the directorate together with officials from the Ministry for Finance participated in the annual meeting with officials from the IMF Mission held in November 2015. During these meetings various issues related to debt management and positions on central government debt were discussed.

II. DG ECFIN and Credit Rating Agencies

Jointly with officials from the Budget Office and the Economic Policy Department, the directorate participated in the Spring forecast meeting held with DG ECFIN in April 2015.

Apart from two teleconferences, officials from the Debt Management Directorate flanked by officials from the Ministry for Finance met with officials from the credit rating agencies on four different occasions to discuss issues related to central government debt, debt issuance strategies and debt management. Such meetings are normally undertaken as part of the credit rating process. After each meeting the Credit Rating Agencies were presented with a report outlining the issues that were discussed during the meetings.

The directorate's contribution in these meetings focused on reviews, ongoing developments and outlooks related to Central Government Debt and Debt Management.

III. EFC sub-committee on EU Sovereign Debt Markets (ESDM)

The DMD continued to participate in the meetings of the Economic and Financial Committee (EFC) Sub-committee on EU *Sovereign Debt Markets* (ESDM) in Brussels. The main objectives of the sub-committee include discussions on issues related to the efficient functioning of the EU's primary and secondary government debt markets as well as contribute to the preparation of EFC common positions on issues which significantly impact the sovereign debt markets. Moreover, the ESDM monitors the changes in the characteristics of the government bond markets and their impact on their function.

During the course of the year 2015, the Debt Management Directorate jointly with officials from CBM participated in four meetings held in Brussels and two teleconferences. The key areas of work focused on the ongoing developments in the sovereign bond markets, market functioning, regulatory issues and their impact on sovereign debt in the financial markets, , follow-up aspects of the implementation of the euro area Collective Action Clauses as well as developments in debt restructuring issues.

IV. Central Bank of Malta

In Central Bank of Malta's (CBM) capacity as adviser to government on finance and economic matters, the directorate regularly held meetings with officials of the bank to discuss matters related to Government securities and the functioning of the domestic sovereign debt market. CBM assisted the directorate in researching bond prices and yields in the secondary market, as well as offered advice during the pricing process in anticipation of a primary market MGS issuances.

In July 2015, the directorate was invited by Central Bank of Malta to deliver a presentation related to the issuance programme of government securities for the year during the meeting of the Financial Markets Committee (FMC) - a forum organised and chaired by CBM which gathers all credit institutions operating in Malta.

Staff Training and Development

The directorate is committed to training and human resources development to ensure that its staff have the right skills to meet its objectives. To this effect it continued to invest in the training and professional development of its human resources, both through in-house programmes and also through external courses organised by local and foreign organisations. During the year 2015 opportunities were offered to directorate staff to attend training courses, seminars and annual conferences organised by local and foreign organisations. These included:

- Third Commonwealth Secretariat Stakeholders Conference on Public Debt Management;
- The 10th annual European Bond Conference organised by the Association for Financial Markets in Europe (AFME);
- AFME/Primary Dealers: European Government Bond Markets Off-Site;
- Financial Sector Assessment Programme organised by CBM;
- The Benefits of IPSAS to Government Accounting in Malta;
- Financial Instruments Workshop (IPSAS);
- Training Session promoting Equality, Managing Diversity - ESF 4.220 – Developing a Culture of Rights through Capacity Building;
- International Trends and Best Practices in Financial Management and Policy Making in the Public Administration organised by PWC in collaboration of CDRT.

Support Services

The directorate's front office continued to offer guidance and provide the necessary services to the heirs of deceased MGS holders so that the heirs can have any inherited government Stocks transferred in their name through a *Causa Mortis* procedure.

In 2015 the directorate received three hundred and seventy-three (373) new *Causa Mortis* claims from the heirs' legal adviser, representing an increase of 2% over the previous year. During the course of the same year the directorate finalised three hundred and eighty (380) cases, of which two hundred and thirty-three (233) were in respect of new claims submitted in the year 2015 whilst the remaining one hundred and forty-seven (147) cases were related to claims opened in previous years.

Online Services

During the year 2015 the Debt Management Directorate continued to make use of the Treasury's website to increase the data available to stakeholders and market participants such that its content better meets the needs of stakeholders and clients in a faster and more efficient manner. The information/statistics/forms uploaded on the website include:

- Market announcements linked to new issuance of Malta Government Stocks;
- The yearly indicative issuance calendar of Government Securities;
- Monthly issuance calendar for Treasury bills;
- The publication of weekly Treasury bills auction results;
- Weekly Treasury bills' auction bid analysis report;
- Malta Government Stocks auction results;

- Investors base of Malta Government Securities;
- The outstanding MGS portfolio;
- The latest credit ratings for Malta government debt;
- The full text of the Model Collective Action Clauses (CACs);
- Concise guidelines intended to guide the heirs of deceased stockholders through the administration tasks related to *'Causa mortis'* claims;
- Various other occasional reports, both of a technical and an informative nature.

18/03/2016