**PEMPAL – TCOP – Cash Management Instruments**

***Video Conference, 19 October 2016***

On 19 October, 36 participants from 12 countries took part in a three-hour video conference on the subject of financial instruments used in cash management. PEMPAL Program Coordinator, Elena Nikulina, and TCOP advisors Ion Chicu and Mark Silins also participated. The VC was centred around a presentation by Mike Williams followed by questions from participants. This is the eighth event convened for this working group, including five VCs convened in 2014 and 2015, a plenary meeting in Tirana, Albania in May 2015, and a workshop in Ankara, Turkey in March 2016. The topic for this VC was one of a number of topics identified by participants for future discussion during the Ankara workshop. The list of participants and videoconference agenda are inserted below.



Mike delivered a thought-provoking presentation which is briefly summarized below. The presentation:

* provided a useful reminder as to the key objectives of cash management, of the benefits that accrue from efficient cash management, and that the policy objectives of cash management do not happen in isolation from other policy objectives, but support fiscal, debt management and monetary policies;
* revisited the importance of a TSA as a tool for centralized cash management. Operating a single bank account, or network of linked accounts, improves control and planning, reduces administrative burdens and by concentrating government’s cash resources in one place, opens up options for more cost-effective management of cash and greater resilience to financial shocks;
* highlighted that once a TSA is in place cash managers are better placed to forecast the balance, and subsequently to seek to “rough” or “fine” tune it, i.e. to smooth cash flows, reducing the volatility of the balance. Treasury bills (Tbills), particularly shorter-term (often 1-month) Tbills were usually the main instrument for rough tuning, whereas fine tuning involved more active management with a wider range of shorter term instruments, in particular sale and repurchase agreements (repo).
* described the various instruments commonly available for tuning the balance, both on the borrowing and investment side. Modern cash management is not just about debt issuance but should also include active investment of short-term cash surpluses; and
* discussed the concept of risk management and identified the major elements of risk pertaining to cash management.

The full presentation is inserted below.



Previously, events for this working group had resulted in the most active question and answers sessions of any VCs. This event stimulated interest beyond the levels seen at earlier events. A summary of some of the key questions and answers is provided below:

* **Risk Management and Collateral** – Mike suggested a future event focused on risk management, including operational risk. In relation to collateral, all government lending should be collateralized. Usually the collateral will be government (and possibly central bank) securities;
* **How to calculate cash buffers** –The size of the required buffer will be determined by a number of factors. These include the volatility of cash flows, the ability to forecast those cash flows and to manage cash in line with the forecasts (which depends on market liquidity), the speed of response in the event of unanticipated cash outflows and the safety nets available. The cumulative forecasting errors over a given period will be a key determinant; the buffer has to allow for the maximum cumulative forecast error over the period before policy can react (which is often about two weeks). An additional component usually needs to be added to allow for potential financial market disruption.
* **Is it possible to target a TSA balance of zero?** Countries with ready access to liquidity and strong forecasting capacity can and do achieve a balance on the TSA that is kept to a very low and constant level; examples include France, the smaller northern Eurozone countries, Sweden and the UK.
* **Coverage of the TSA** – While it is difficult to be prescriptive, a good-practice TSA would normally extend to all central government entities, including those which are outside the budget or have some legal independence. This would include non-profit statutory bodies and extra budgetary funds. There is a range of international practice in relation to subnational government entities: coverage may depend on the degree of central government control over the budgets of lower level governments.
* **Should joint stock companies or other state-owned enterprises be included?** In general, commercial entities require operational and management flexibility and independence, and these are not typically included in the TSA, particularly where they operate in a competitive environment. However, those that are essentially arms of government delivering fiscal policies should normally be included;
* **Should the Central Bank invest on behalf of governments? –** In general, cash investment and borrowing are the responsibility of government and not the Central Bank. On occasions central banks have assumed responsibility due to a lack of capacity in the government; but then it should be clear that the central bank is acting as an agent of government. Once capacity is in place, the central bank should transfer responsibility. Different issues arise in relation to any structural cash surplus, the investment of which is not normally the responsibility of the cash manager who will be handling only short-term cash surpluses (of up to, say, 3 months). Structural surpluses would be subject to separate management and governance arrangements and invested against a strategic asset allocation taking account of medium and longer term objectives for the government balance sheet. In some countries the structural surplus is invested (e.g. as a stabilization fund) through the central bank’s balance sheet, although it will be identified separately in the accounts.
* **Should the government invest any temporary surplus cash with the central bank, e.g. as term deposits?** In general this is not a recommended arrangement. It fails to secure the benefit in terms of smoother cash flows of investing surpluses back into the banking sector. However, if there is a structural excess of liquidity (e.g. as a result of foreign currency inflows that have not been sterilized) it would be acceptable to leave the cash with the central bank (at a market-related interest rate) to avoid creating further problems for monetary policy.
* **Operating time horizon for forecasting the TSA balance –** Ideally countries should seek to develop capacity to forecast the balance of the TSA at least three months ahead, ideally on a daily basis, although in practice countries move from monthly to weekly to daily forecasts as capability develops. The forecasting horizon should also continually be updated, rolling forward to cover an additional week or month as each period is completed.

At the conclusion of the Q+A segment, Mark Silins was invited to comment.

Firstly, he thanked Mike for his excellent presentation and also extended his thanks to participants for their thoughtful questions and active engagement. Mark highlighted a number of key points raised during the VC:

* Improvement in cash management is likely to be a gradual process, building capacity over time particularly in relation to forecasting;
* Fine-tuning is very challenging and not operating in many PEMPAL countries – it may not be attainable for all countries; for example, very few countries currently have access to a liquid money market and repos;
* In determining the coverage of the TSA and any central government cash management function, the focus can be on how to benefit from consolidation and to share those benefits, and how to reduce risks, particularly underperformance risks through passive cash management practices;
* Zero balance accounts for spending provide a useful way to allow operational autonomy during the day while centralizing cash balances overnight;
* Models can be useful, although as Mike says a combination of analysis of historical flows and common sense about what is happening will often be more useful than sophisticated econometric modelling. The monitoring of the outturns is also critical, including investigating the cause of errors between the forecast and outturn, and taking the lessons learnt into account in future forecasts.
* Mark also drew participants’ attention to two papers that Mike has published including one on the relationship with the Central Bank, an issue raised in today’s session (the latter is at www.imf.org/external/pubs/ft/tnm/2012/tnm1202.pdf;

the other, on interaction between cash management and other financial policies, is at www.imf.org/external/pubs/ft/tnm/2010/tnm1013.pdf).

Ion Chicu brought the discussion to a close by inviting each country to propose further topics for future events. The working group activity plan has room for further VCs, such as for today, as well as for another face-to-face meeting tentatively planned for spring 2017. The Federal Treasury (FT) of Russia informed the resource team before the VC of the principal agreement to host such meeting in late March – early April. Representatives of the Federal Treasury attending the VC confirmed that the matter was discussed with the FT senior management and high level approval received. The group further discussed that the agenda of the event should combine further familiarization with the experience of Russia in various dimensions of cash management with the expert presentations and sessions for other countries to share their experience and discuss matters of priority interest for the majority of the group members. The exact dates of the meeting are still to be confirmed with the hosts, after which the resource team will launch the work on the event concept and will invite all the group members to contribute through provision of suggestions on the issues to be covered.

It was also agreed that in order to prepare for the Moscow event the group will organize another videoconference in mid-February 2017, the agenda of which will combine a thematic session (the topic to be confirmed closer to the VC date) with the discussion of organizational issues for the upcoming face-to-face event.