COLOMBIA

GOVERNMENT DEBT AND RISK MANAGEMENT PROGRAM (GDRM):
OUTCOMES AND IMPLEMENTED REFORMS

Prepared by:

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Alessandro Scipioni (international consultant)

May, 2016
### Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>MHCP</td>
<td>Ministry of Finance (Ministerio de Hacienda y Crédito Público)</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>DGCPTN</td>
<td>General Directorate of Public Credit and National Treasury (Dirección General de Crédito Público y Tesorería Nacional)</td>
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<tr>
<td>SECO</td>
<td>Swiss State Secretariat for Economic Affairs, Swiss Cooperation</td>
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<tr>
<td>GDRM</td>
<td>Government Debt and Risk Management, World Bank Program</td>
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<tr>
<td>BR</td>
<td>Central Bank (Banco de la República)</td>
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<tr>
<td>CONFIS</td>
<td>Superior Council of Fiscal Policy (Consejo Superior de Política Fiscal)</td>
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<td>CONPES</td>
<td>Superior Council of Economic and Social Policy (Consejo Superior de Política Económica y Social)</td>
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<tr>
<td>DNP</td>
<td>National Planning Department (Departamento Nacional de Planeacion)</td>
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<tr>
<td>DAF</td>
<td>Fiscal Support Directorate (Dirección de Apoyo Fiscal, MHCP)</td>
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<td>NFPS</td>
<td>Non-Financial Public Sector</td>
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<tr>
<td>CG</td>
<td>Central Government</td>
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<tr>
<td>MTDS</td>
<td>Medium-Term Debt Management Strategy</td>
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<tr>
<td>TES</td>
<td>Treasury Bonds (Republic of Colombia)</td>
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<td>TESM</td>
<td>TES issued for monetary control purposes</td>
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<tr>
<td>TESCO</td>
<td>T-Bills (Republic of Colombia)</td>
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<tr>
<td>OMO</td>
<td>Open Market Operations</td>
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<td>PCO</td>
<td>Public Credit Operations</td>
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<tr>
<td>LMO</td>
<td>Liabilities Management Operations</td>
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<tr>
<td>ALM</td>
<td>Asset and Liability Management</td>
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<tr>
<td>TGN</td>
<td>Government’s Treasury (Tesorería General de la Nación)</td>
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<td>TSA</td>
<td>Treasury Single Account (Cuenta Unica Nacional)</td>
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<td>SLF</td>
<td>Security Lending Facility</td>
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<tr>
<td>NCS</td>
<td>Non Competitive Subscriptions</td>
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<td>PD</td>
<td>Primary Dealers</td>
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<td>PPP</td>
<td>Public Private Partnerships</td>
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<tr>
<td>COP</td>
<td>Colombian Pesos</td>
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<tr>
<td>UVR</td>
<td>Inflation Index (Unidad de Valor Real)</td>
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Preface

This report summarizes the main outcomes of the Government Debt and Risk Management Program (GDRM) in Colombia.

The GDRM program, funded by the Swiss State Secretariat for Economic Affairs (SECO) and implemented by the World Bank (WB), supported Colombia from 2012 – 2015 in the implementation of debt management reforms.

The World Bank would like to thank the Colombian authorities and the team at the General Directorate of Public Credit for their continuous commitment and fruitful partnership.
Executive Summary

The Colombian government has embarked on a series of reforms aimed at reducing vulnerability of the government’s balance sheet to financial shocks. Among those, it’s worth noting significant efforts to strengthen public debt and cash management.

Through its Government Debt and Risk Management (GDRM) program, funded by the Swiss State Secretariat for Economic Affairs (SECO), the World Bank (WB) supported Colombia, in particular the General Directorate of Public Credit and National Treasury (DGCPTN), in the implementation of priority public debt management reforms.

The GDRM program has five focus areas, which basically cover the whole span of debt management activities. The program supported Colombia in implementing reforms in all five areas as noted below.

<table>
<thead>
<tr>
<th>FOCUS AREAS</th>
<th>COMPONENTS IN COLOMBIA</th>
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</thead>
<tbody>
<tr>
<td>Governance</td>
<td>Policy for Issuing Central Government Guarantees</td>
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<tr>
<td></td>
<td>Formalization of the Institutional Framework of the Debt Management Strategy</td>
</tr>
<tr>
<td></td>
<td>Non-Financial Public Sector (NFPS) Borrowing</td>
</tr>
<tr>
<td>Policy Coordination</td>
<td>Improve coordination between the Central Bank and the MHCP</td>
</tr>
<tr>
<td></td>
<td>Strengthen Coordination between the DGCPTN and the Macro Policy Directorate</td>
</tr>
<tr>
<td></td>
<td>Improve Coordination between Debt and Cash Management</td>
</tr>
<tr>
<td>Capacity and Management of Internal Operations</td>
<td>Revision of the internal organization of the DGCPTN</td>
</tr>
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<td></td>
<td>Business processes and manuals of procedures</td>
</tr>
<tr>
<td>Debt Management Strategy and Risk Management</td>
<td>Update and Improvement to the Analytical Model</td>
</tr>
<tr>
<td></td>
<td>Design and Review of the medium-term DMS and creation of an Annual Borrowing Plan</td>
</tr>
<tr>
<td>Borrowing and Related Financing Activities</td>
<td>Further development of the domestic debt market in the areas of:</td>
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<tr>
<td></td>
<td>a. Primary Dealers Program</td>
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<td></td>
<td>b. Issuance Program and LMOs</td>
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<td></td>
<td>c. Diversification of the investor base</td>
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<td></td>
<td>d. Security lending Facility</td>
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<td></td>
<td>e. Coordination of primary issuance with monetary policy</td>
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</table>

The GDRM program has a strong focus on outcomes. The nature of the program – a medium-term approach combined with tailored downstream assistance – was fundamental to achieving a number of important outcomes, which have supported Colombia in increasing its resilience to financial shocks and improving efficiency of debt management operations, making the program very successful as will be illustrated in the goals that were accomplished. The use of a resident advisor also played an important role in reaching important results.
A high number of critical outcomes were achieved. Although one cannot claim that all outcomes were generated by the program – all outcomes are, at the end, merit of measures taken by the authorities – it is certainly fair to say that the program played a fundamental role in catalyzing such achievements. The program was also successful in areas that are typically difficult to address in most countries, such as coordination mechanisms between the Ministry of Finance and the Central Bank, establishment and implementation of a debt management strategy, institutional reorganization, and changes in the legal framework.

The present report summarizes the main outcomes achieved by the DGCPTN under the GDRM framework. In this executive summary, only the main outcomes are highlighted, whereas in the report full details are given regarding all outcomes, activities and products delivered by the WB team.

In the area of governance of public debt management, outcomes included (i) improved management of contingent liabilities, through an enhanced central government’s (CG) policy on the issuance of guarantees; (ii) further formalization of the institutional framework of the debt management strategy (DMS); and discussions and proposals to improve the DGCPTN’s role on borrowing by non-financial public sector (NFPS) entities. The main outcomes on this area are summarized in the table below and a comprehensive description is provided in the main text.

### Key outcomes in governance of public debt management

<table>
<thead>
<tr>
<th>TOPICS</th>
<th>OUTCOMES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policy for Issuing Central Government Guarantees</td>
<td>Improved methodology to price guarantee fees and set collateral to obtain central government’s guarantees. New methodology formally approved through Ministerial Resolution.</td>
</tr>
<tr>
<td>Formalization of the Institutional Framework of the Debt Management Strategy</td>
<td>Institutional framework explained and published in the book on the DMS published by the Ministry. Proposal to formalize the procedures to design, approve and monitor the DMS, including the creation of a debt management committee and the requirement in law for a DMS.</td>
</tr>
<tr>
<td>Non-Financial Public Sector (NFPS) Borrowing</td>
<td>Based on a comprehensive proposal prepared within the program, the DGCPTN is currently discussing criteria for NFPS borrowing which will be included in the modification of the Decree 2681. Ministry approved a new Decree (1068) which compiles current legal provisions on Debt Management.</td>
</tr>
</tbody>
</table>

On policy coordination, a number of important outcomes were generated through the program, such as (i) improvement in the coordination between the MHCP and the Central Bank, through the resumed issuance of T-bills by the MHCP and the discontinued issuance of TESM by the Central Bank; (ii) strengthened coordination between the DGCPTN and the Macro Policy Directorate, leading to better flow of information and improvement on the inputs to the cost-at-risk model; and (iii) enhanced coordination
between debt and cash management, through the establishment of an investment policy for the excess of liquidity in USD and the development of a manual of procedures for Treasury operations. The main outcomes on this area are summarized in the table below and a comprehensive description is provided in the main text.

**Key outcomes in policy coordination**

<table>
<thead>
<tr>
<th>TOPICS</th>
<th>OUTCOMES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improve coordination between the Central Bank and the MHCP</td>
<td>TESCO (T-Bills) issuance has been reintroduced in 2015.</td>
</tr>
<tr>
<td></td>
<td>Central Bank abandoned its program to issue TESM (securities issuance for monetary purposes).</td>
</tr>
<tr>
<td>Strengthen Coordination between the DGCPTN and the Macro Policy Directorate</td>
<td>Risk Unit obtains better information from the Macro Policy Directorate.</td>
</tr>
<tr>
<td></td>
<td>Inputs to the Cost-at-Risk Model have been improved.</td>
</tr>
<tr>
<td>Improve Coordination between Debt and Cash Management</td>
<td>Establishment of an investment policy - and development of a manual - for government’s excess of liquidity in USD.</td>
</tr>
<tr>
<td></td>
<td>Development of an Operational Manual of Treasury transactions to mitigate operational risk.</td>
</tr>
</tbody>
</table>

Although part of the original program in the area of capacity management of internal operations was integrated in an internal project of the DGCPTN to consolidate its information technology system and part of that put on hold, important outcomes were also achieved by the GDRM program, such as (i) the reorganization of the DGCPTN with the creation of the General Directorate of State Holdings outside the DGCPTN and the Deputy Directorate of PPPs; (ii) the revision of the Mission, Vision and objectives of the DGCPTN, as well as a proposal for a new Business Model; and (iii) the development of the market risk manual and the book on the formulation of the debt management strategy. The main outcomes on this area are summarized in the table below and a comprehensive description is provided in the main text.

**Key outcomes in capacity and management of internal operations**

<table>
<thead>
<tr>
<th>TOPICS</th>
<th>OUTCOMES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revision of the internal organization of the DGCPTN</td>
<td>Reorganization of the DGCPTN with the creation of the General Directorate of State Holdings (<em>Dirección General de Participaciones Estatales</em>) outside the DGCPTN and the Deputy Directorate of PPPs.</td>
</tr>
<tr>
<td></td>
<td>Revision of the Mission, Vision and objectives of the DGCPTN.</td>
</tr>
<tr>
<td></td>
<td>Proposal for a new Business Model for the DGCPTN.</td>
</tr>
<tr>
<td>Business processes and manuals of procedures</td>
<td>DMS book published (available on website).</td>
</tr>
<tr>
<td></td>
<td>Manual on market risk management developed.</td>
</tr>
</tbody>
</table>
On the elaboration of a debt and risk management strategy, a remarkable outcome is having debt operations in Colombia steered by a formal medium-term debt management strategy, improving governance, risk management, accountability, and transparency of government debt management. The debt management strategy, proved to be fundamental in building resilience, as evidenced by recent emerging market turmoil. Besides, in the process of developing and implementing the strategy, outcomes also included the development and documentation of an analytical model and the improvement on public debt management reporting. The main outcomes on this area are summarized in the table below and a comprehensive description is provided in the main text.

Key outcomes in the elaboration of the medium-term debt management strategy (DMS)

<table>
<thead>
<tr>
<th>TOPICS</th>
<th>OUTCOMES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Update and Improvement to the Analytical Model</td>
<td>Cost-at-Risk Model developed and documented.</td>
</tr>
<tr>
<td>Design and Review of the medium-term DMS and creation of an Annual Borrowing Plan</td>
<td>Medium Term Debt Management Strategy proposed by the Risk Unit and approved and published by the Finance Minister in 2012. Annual Debt Report published in the Ministry Website and a new and more comprehensive report drafted. Draft of a quarterly report on compliance with the DMS.</td>
</tr>
</tbody>
</table>

On the development of the domestic market for government securities, a number of important outcomes were achieved, such as: (i) diversification of the investor base, which increases resilience against shocks and fosters market development; (ii) reduction of yield curve distortions, providing the market with a better benchmark that helps reducing borrowing costs and promoting the private market; and (iii) improvement in liquidity and the debt portfolio profile through the use of liability management operations. The main outcomes on this area are summarized in the table below and a comprehensive description is provided in the main text.

Key outcomes in domestic market development

<table>
<thead>
<tr>
<th>TOPICS</th>
<th>OUTCOMES</th>
</tr>
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<tbody>
<tr>
<td>Further development of the domestic debt market in the areas of:</td>
<td>Reduction of withholding taxes on foreign holders of Treasury Bonds and increased participation of non-residents in the local debt from around 6% in 2011 to 18% in 2015.</td>
</tr>
<tr>
<td>a. Primary Dealers Program</td>
<td>Reduction of yield curve distortions.</td>
</tr>
<tr>
<td>b. Issuance Program and LMOs</td>
<td>DGCPTN made a major Liability Management Operation with the Market in 2014 to improve the debt redemption profile, extend average life of the debt portfolio, and increase the liquidity in the secondary markets.</td>
</tr>
<tr>
<td>c. Diversification of the investor base</td>
<td>T-Bills issuance reintroduced in 2015.</td>
</tr>
<tr>
<td></td>
<td>Abandon of Central Bank issuance of securities for monetary control purposes.</td>
</tr>
</tbody>
</table>
Although a second phase of the GDRM program maybe launched only in 2017, in the short term, the WB and SECO agreed to reallocate some resources from other countries that will not be able to fully implement its programs to Colombia. In this context, the WB and SECO will discuss with the authorities a short-term – July 16 to July 17 - program to address some of the issues that were discussed and underlined in this report as potential additional technical assistance. Potential areas include:

- Coordination of the debt and cash management strategies;
- Review of the debt management strategy in light of structural changes;
- Capacity building on the use of derivatives;
- Validation of the liquidity risk model;
- Support for the investor relations function;
- Systematic approach to the use of liability management operations; and
- Review of the issuance strategy.
Introduction

Effective public debt management is a cornerstone of financial stability and sustainable fiscal policy. The composition of public debt has been an important factor in many economic and financial crises, as excessive exposure to changes in exchange rates and interest rates can result in large negative impacts on public finances. During the 2008-2009 crisis, however, middle-income countries generally performed well. This was a result of sound macroeconomic policies and particularly prudent public debt management, focused on reducing risks and promoting domestic market development.

On its turn, the Colombian government has embarked on a series of reforms aimed at reducing vulnerability of the government’s balance sheet to financial shocks. Among those, it’s worth noting significant efforts to strengthen public debt and cash management. In 2011, the Ministry of Finance (Ministerio de Hacienda y Crédito Publico or MHCP) requested support from the World Bank (WB) Treasury to implement specific reforms in public debt management, in line with international sound practices.

TheWB delivered this technical assistance (TA) through its Government Debt and Risk Management (GDRM) program, supporting Colombia, in particular the General Directorate of Public Credit and National Treasury (DGCPTN), in implementing the priority public debt management reforms.

The Government Debt and Risk Management Program (GDRM), funded by the Swiss State Secretariat for Economic Affairs (SECO), was established in 2011 to provide support to middle-income countries on public debt and risk management. The development objectives of the program are to improve macroeconomic and fiscal management and reduce vulnerability to financial shocks through (i) strengthened public debt and risk management capacity and institutions and (ii) deeper domestic debt markets.

Within the GDRM program, advisory services are organized around five focus areas to help governments develop and implement sound debt and risk management strategies. These areas range from the high-level governance and institutional arrangements that shape the enabling environment and support accountability, through policy coordination and determining the composition of public debt, to the implementation of transactions in the markets.

In this context, support was provided to Colombia in all five focus areas of the program:

1. Governance of public debt management, with a focus on improving the enabling environment for effective debt management;
2. Policy coordination, aiming at a sound coordination between debt management and cash management, fiscal policy, and monetary policy implementation;
3. Capacity and management of internal operations, in particular strengthening the organizational structure of the DGCPTN;
4. Debt Management Strategy and Risk Management, whereby the DGCPTN prepares, updates and implements a medium-term debt management strategy (DMS) and annual borrowing plan; and
5. **Borrowing and related financing activities**, aimed at contributing to the further development of the domestic market and the efficiency of the government’s borrowing.

Within these five general intervention strategies the WB Treasury supported the DGCPTN in numerous activities and delivered several products (reports, aide memoires, technical notes etc).

The present report summarizes the main outcomes achieved by the DGCPTN under the GDRM framework, which has a strong focus on outcomes. The nature of the program – a medium-term approach combined with tailored downstream assistance – was fundamental to achieving a number of important outcomes, which have supported Colombia in increasing its resilience to financial shocks and improving efficiency of debt management operations, making the program very successful as will be illustrated in the goals that were accomplished. The use of a resident advisor also played an important role in reaching important results.

The GDRM program has The nature of the program – a medium-term approach combined with tailored downstream assistance – was fundamental to achieving a number of important outcomes, which have supported Colombia in increasing its resilience to financial shocks and improving efficiency of debt management operations

It also consolidates the main outputs produced and delivered by the WB, as well as the main activities that were undertaken under the program. All products and activities had the goal to support the DGCPTN in achieving the desired outcomes.

The report is divided into five sections, with each section corresponding to a focus area of the GDRM program. In its turn, each section is divided in three subsections, containing (i) progress made until March 2016; (ii) recommendations for further strengthening public debt and cash management in the respective areas; and (iii) potential future technical assistance as discussed with the authorities during the latest mission (March 2016).
1. Governance

The first component of the GDRM program was meant to raise the authorities’ awareness of the need to strengthen governance arrangements and institutional structures. From a governance perspective, one of the major achievements was the improvement of the government policy on the issuance of guarantees (contingent liabilities) formalized with the new Ministerial Resolution on government guarantees approved in 2015.

Furthermore, the DGCPTN has also made progress in the formalization of the institutional framework of the debt management strategy. In this context, the coordination among the various deputy directorates within the DGCPTN was substantially improved. The government published a book explaining the institutional framework of the debt management strategy (DMS) and the strategy itself, and a proposed was developed to formalize the procedures to design, approve and monitor the DMS. However, some decisions still tend to be taken in an informal manner and DGCPTN lacks some additional strict platforms for decisions (committees, regular meetings, etc.).

Another important achievement of the DGCPTN was to consolidate a very fragmented legislation on public debt management through the approval of the Presidential Decree 1068 (2015). This decree should be seen as a first step in the process to update and improve Colombian legislation on public debt management. Next step should be to further incorporate other recommendations made by the World Bank, notably on the institutionalization of medium-term debt strategy. Finally, in the long run, DGCPTN could consider establishing a single Public Debt Management law to modernize current legislation on this topic, although this work would be very resource-consuming as there are a number of legislation acts impacting DGCPTN’s activities.

The program also supported the authorities in assessing the criteria for non-financial public sector (NFPS) borrowing and the DGCPTN’s role on that. A proposal on improving the institutional arrangements for NFPS borrowing produced within the program will provide a basis upon which the government will take actions to enhance the process.

A. Progress made by March 2016

Table 1 shows the main activities of the program under this component and outcomes obtained by the DGCPTN to improve governance in managing public debt, as well as the products delivered by the World Bank during the technical assistance.

Table 1. Progress made in Governance

<table>
<thead>
<tr>
<th>TOPICS</th>
<th>MAIN ACTIVITIES</th>
<th>OUTCOMES</th>
<th>PRODUCTS DELIVERED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policy for Issuing Central Government Guarantees</td>
<td>World Bank virtual sessions with other countries.</td>
<td>Improved methodology to price guarantee fees and set collateral to obtain CG’s guarantee.</td>
<td>Diagnostic of CG’s guarantee policy and recommendations for improvement.</td>
</tr>
<tr>
<td></td>
<td>Review of current norms and discussion of criteria for Public Entities to receive guarantees from the central government.</td>
<td>New methodology formally approved</td>
<td>Presentation on CG’s guarantee policy.</td>
</tr>
</tbody>
</table>
Review of other countries’ policies and international literature.  
Review of the methodology to price guarantee fees for the Contingency Fund and proposal of a new methodology in line with Basel guidelines.  
Review of the methodology to set required collateral to obtain CG’s guarantee.  

| **Formalization of the Institutional Framework of the Debt Management Strategy** | **Review of the legislation on public debt management. Presentation of the institutional framework in other countries and international best practices.** | **Proposal to formalize the procedures to design, approve and monitor the DMS.** | **Proposed ToR for the creation of a Debt Management Committee.** |
| | **Internal survey and interviews with all the Deputy Directors on the institutionalization of the DMS.** | **Proposal for the creation of a Debt Management Committee.** | **Proposed modifications to the Decree 2681.** |
| | **Preparation of a proposal to formalize the procedures to design, approve and monitor the DMS.** | **Proposal to include the requirement of a DMS in the Decree 2681.** | **Note on the institutionalization of the DMS.** |
| | **Dissemination of the proposal and follow up with the Deputy Directors.** | **Institutional framework explained and published in the book on the DMS published by the Ministry.** | |
| | **Integration and harmonization of recommendations from World Bank and IMF missions.** | | |

| **Non-Financial Public Sector (NFPS) Borrowing** | **Raise of DGCPTN awareness of current deficiencies of the NFPS borrowing process.** | **DGCPTN is currently internally defining criteria for NFPS borrowing which will be included in the modification of the Decree 2681.** | **Proposal on alternate institutional arrangements for managing the NFPS borrowing process.** |
| | **Gathering of comments and feedback on the proposal made by the World Bank.** | **Ministry approved a new Decree (1068) which compiles current legal provisions on Debt Management.** | **Presentation on subnational borrowing.** |
| | **Discussions of the proposal with DGCPTN.** | | |
| | **Discussions on the roles of DNP, DAF, DGCPTN and CONPES in NFPS borrowing and financial analysis performed.** | | |

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**Central Government’s Policy on the Issuance of Guarantees**

On this topic, the primary outcome envisioned by the project has been reached. Indeed, the National Comptroller (*Contraloría*) requested the Ministry of Finance to produce a written policy on central government’s (CG) guarantees for non-financial public sector (NFPS) borrowing. In 2014, the DGCPTN produced a draft and then further strengthened the new policy by modifying and approving the Ministerial Resolution on CG’s guarantees in 2015.

Essentially, the DGCPTN changed its methodology to determine the fees to be charged to public entities when receiving CG’s guarantees (these fees are set aside in a Contingency Fund that belongs to the CG). The DGCPTN also changed its methodology to set the required collateral from those public entities.
The new methodology has been designed by the Risk Unit of the DGCPTN following state-of-the-art literature and extensive discussions with other countries during World Bank-facilitated sessions. Guarantee fees are determined according to the probability of default of the entity and the estimated loss given default, which is calculated from the exposed amount and a credit recovery rate. The methodology is in line with Basel III guidelines.

Moreover, the DGCPTN managed to apply the new methodology to three new external loans obtained by Findeter, Icetex and Bancoldex with multilateral organizations; all covered by a central government guarantee.

For example, in the case of Icetex’s external loan, collateral provided by Icetex represents 130% of the loan amount. Indeed, the public entity offers a recourse claim of 100% of the loan amount and the remaining 30% through a claim on Icetex’s portfolio of students’ loans. Initially, the idea was to request all the collateral in the form of claims on Icetex’s portfolio of students’ loans, but in the end the government asked for a recourse claim on a bank account of Icetex, as suggested by the World Bank team.

**Formalization of the institutional framework of the Debt Management Strategy**

The project baseline indicator (defined in 2011) targeted the elaboration of a reference manual on the Colombian debt management strategy (DMS). This target has been reached, and even exceeded, with the publication of a book on the medium-term DMS (available on the Ministry website since 2013), which solved to a great extent DGCPTN’s recurrent problems of institutional memory. Indeed, the DMS institutional framework, as well as DGCPTN previous work on strategy modelling and on the process to elaborate the strategy had never been documented before.

In addition, DGCPTN managed to complete its compiling work of current legal provisions on public debt management and propose a new presidential decree (1068) which has been approved in 2015. In doing so, the legal unit of the DGCPTN has updated an old decree (2681 from 1993) which regulated public credit and debt management operations, a decree having the force of a law (decree-law) rather than a simple rule of law.

Next steps should be to further improve the new Decree 1068. For example, the DGCPTN could consider several additional modifications suggested by the World Bank team to the old Presidential Decree 2681, like the establishment of a high level debt management committee. In that sense, a new proposal for the institutional framework of the DMS was elaborated by the Risk Unit, with the support of the World Bank team, and presented to the new Director of the DGCPTN, who joined the Ministry in 2015. This proposal also contained a template report to periodically evaluate compliance with the medium-term strategy, which has been further developed compared to the one presented to the World Bank team in 2014.

Several technical discussions on this proposal are continuing (see discussion on section 4 of the present report) and the debt management strategy itself needs to be revisited in light of structural changes in the economy, notably a medium-term revision of key macroeconomic variables such as persistently low international oil prices and depreciated exchange rate against the USD.
The Risk Unit took the lead on this work, but DGCPTN should ensure the coordination with other Deputy Directorates do not lose momentum. The task may be eased by the recent creation of a new Deputy Directorate that will be responsible for PPPs, thus allowing the Risk Unit to focus on its core business.

**Non-Financial Public Sector Borrowing**

In order to clarify the role of the DGCPTN on debt management of other public sector entities, the Directorate decided to redefine the criteria for approving non-financial public sector (NFPS) borrowing and integrate the new criteria in the Decree 2681. This work is still in progress.

In May 2014, the World Bank Treasury produced a report to raise Colombian authorities’ awareness of current weaknesses in the NFPS borrowing and supported discussions between the DGCPTN and other central government entities involved in this field (DNP and DAF). The report made several recommendations, notably to:

- Change the current one-size-fits-all borrowing authorization process for public entities in order to streamline it for large decentralized entities, large municipalities and larger States that have stronger financial balance sheets;
- Strengthen financial information flows between the DNP, the DGCPTN and the DAF;
- Reduce overlapping evaluations and authorization conducted by the DNP, the DGCPTN and the DAF;
- Reduce red tape in the authorization process;
- Improve the quality and timing of the financial information provided by the NFPS entities to the central government;
- Create a client-facing function to handle NFPS entities’ requests and avoid current dispersion of services provided by various units of the DGCPTN and other directorates of the MHCP.

The report has been submitted and discussed with the Director of the DGCPTN and key staff, whom recognized the desirability of these recommendations but do not consider it as a top priority in the list of reforms to be undertaken by the DGCPTN in the short term.

However, following a verdict of the State Council (*Consejo del Estado*) which deems that DNP does not have to issue an opinion for NFPS borrowing when the borrowing does not concern investment expenditure, the decree 2681 has been amended in 2015. As a result, the coordination between the DNP and the DGCPTN has been strengthened to facilitate the NFPS borrowing authorization process. Furthermore, the DGCPTN responsibilities increased and the Directorate has now a better control of this process.

**B. Recommendations**

1. Before starting any work on the creation of a new consolidated public debt management law, the DGCPTN should finalize the modernization of the new Presidential Decree 1068. This new decree could considerably strengthen governance arrangements and the institutional framework of public debt management in Colombia, along the lines that were suggested in WB reports.
2. Modifications to the Decree 1068 could include the creation of a Debt Management Committee and the requirement of an annual report on DGCPTN’s compliance with the medium-term debt management strategy. Ultimately, this will allow publication of an annual review of the strategy and an annual borrowing plan.

3. The DGCPTN should formalize a Technical Committee which could meet on a monthly basis, before bringing up results to higher levels of the Ministry. Otherwise, there is a risk the Minister does not see the added value of a Debt Management Committee.

4. Technical discussions on the new proposal made by the Risk Unit to formalize the procedures to design, approve and follow up the MTDS should lead to the approval of this process by the Director and the inclusion into the legislation.

5. Regarding NFPS borrowing, the DGCPTN should continue the redefinition of criteria to approve NFPS borrowing and evaluate the level of priority of reforms proposed in the World Bank Treasury Report.

C. Possible additional technical assistance
For the short term, no specific further assistance on governance issues was discussed with the authorities, although some other areas of TA discussed can indirectly support improvement on this area as well.
2. Policy Coordination

This section covers the coordination matters between monetary policy, implemented by the Central Bank, public debt management, cash management (under the responsibility of the DGCPTN) and fiscal policy (Ministry). In the case of Colombia, where the domestic debt market is already relatively well developed for emerging market standards, those coordination issues can be complex and improvements can result in substantial efficiency gains and cost savings. Indeed, the improvements achieved in the coordination between the Central Bank and the MHCP headed to excellent outcomes. Improvements were also achieved in the coordination between debt management and fiscal policy and between debt and cash management.

On policy coordination, a number of important outcomes were generated through the program, such as (i) improvement in the coordination between the MHCP and the Central Bank, through the resumed issuance of T-bills by the MHCP and the discontinued issuance of TESM by the Central Bank; (ii) strengthened coordination between the DGCPTN and the Macro Policy Directorate, leading to better flow of information and improvement on the inputs to the cost-at-risk model; and (iii) enhanced coordination between debt and cash management, through the establishment of an investment policy for the excess of liquidity in USD and the development of a manual of procedures for Treasury operations.

A. Progress made by March 2016

Table 2 shows the activities of the program and outcomes obtained by the DGCPTN to strengthen coordination between monetary policy, debt and cash management, as well as the products delivered by the World Bank team during the technical assistance program.

<table>
<thead>
<tr>
<th>TOPICS</th>
<th>MAIN ACTIVITIES</th>
<th>OUTCOMES</th>
<th>PRODUCTS DELIVERED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strengthen Coordination between the DGCPTN and the Macro Policy Directorate</td>
<td>Review of the inputs needed for the Cost-at-Risk Model, especially projections of macro variables. Technical discussions between the DGCPTN’s Risk Unit and the Macro Policy Directorate to improve coordination.</td>
<td>Risk Unit obtains better information from the Macro Policy Directorate. Inputs to the Cost-at-Risk Model have been improved.</td>
<td></td>
</tr>
</tbody>
</table>
### Improve Coordination between Debt and Cash Management

<table>
<thead>
<tr>
<th>Improvement</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>World Bank mission (June 2015) on cash management: technical discussions and action plan.</td>
<td>Teleconference on coordination between debt and cash management with World Bank experts.</td>
</tr>
<tr>
<td>Review of operational risk in current Treasury operations.</td>
<td>Establishment of an investment policy for government cash flows in USD.</td>
</tr>
<tr>
<td>Note on government investment policy of excess of liquidity in USD.</td>
<td>Action plan for the Treasury to improve cash management.</td>
</tr>
</tbody>
</table>

### Improved coordination between the Central Bank and the MHCP

Regarding the coordination between the Central Bank and the Ministry of Finance, outcomes were above expectations. The Ministry resumed issuance of T-Bills (TESCO) in 2015, thus offsetting the lack of short-term government securities in the market, which was identified as one of the major problems of the Colombian fixed-income market.

Moreover, the Central Bank abandoned its program to issue securities for monetary control purposes, thus improving coordination between MHCP and CB on primary market issuance, and substantially strengthening the separation between debt management and monetary policy.

Those two major modifications to the government securities market were the main recommendations of the World Bank mission team in June 2014, which established a detailed diagnostic on coordination issues between the Central Bank and the MHCP.

The report also estimated that the volatility of the National Treasury deposits in the Central Bank generates complications for the Central Bank to implement its monetary policy because it contributes to the volatility of Colombian money market rates. Changes in the National Treasury Deposits are the main driver of changes in the monetary base of the country, forcing the Central Bank to adjust its open markets operations (mainly repos) according to the variation in the deposits’ outstanding.

One of the key variables explaining movements in the Treasury deposits is the debt repayment. The current domestic debt issuance strategy tends to create a major concentration of debt redemption at a specific date each year in order to create benchmark securities. Thus, the Treasury tends to accumulate deposits in the months preceding the redemption date, generating thereby a substantial cost of carry. Reducing this cost of carry could be an area for further technical assistance, and a systematic program of liability management operations could be one way to efficiently cope with that.

### Strengthened coordination between the DGCPTN and the Macro Policy Directorate

A better coordination between the DGPCTN and the Macro Policy Directorate is certainly another achievement of the program. The Risk Unit managed to obtain more detailed inputs, and in a timely
manner, from the Macro Policy Directorate (notably projections of macro variables) to use in its Cost-at-Risk Model to help identifying the Debt Management Strategy. The transmission of the information is still done on ad-hoc requests and not through a systematic mechanism, what could be a further improvement.

Although the Cost-at-Risk Model has evolved significantly, the DGCPTN is still working on obtaining even more detailed and comprehensive information from the Macro Policy Directorate. Further improving the Cost-at-risk model is one of the targets of the Risk Unit for 2016.

Improved coordination between Debt and Cash Management
The DGCPTN completed two major steps to strengthen coordination between debt and cash management. In 2014, The Deputy Directorate of Treasury established a risk management policy to handle its excess liquidity in dollars. It also reviewed, with the help of the Risk Unit, its manual for Treasury Operations in order to decrease operational risk.

However, there is still work to do in that direction, as it has been underlined in the action plan for the Treasury prepared by the World Bank team in June 2015. This is certainly the main area where DGCPTN would need further technical assistance in the future.

Although the DGCPTN is currently programming cash flows of the annual budget on a daily basis, cash flows forecasting capacity could be further improved. This would notably require obtaining better forecasts from line ministries and entities participating in the Treasury Single Account.

Strengthening cash flows forecasting capacities of the Treasury is important for the implementation of the Central Bank monetary policy as well and, thus also for the development of the Colombian money market. Indeed, the volatility of Treasury cash flows generates volatility in the Treasury deposits in the Central Bank and in the monetary base of the country, as it has been explained before. Therefore, it directly affects the excess demand of money that the Central Bank must tackle with monetary expansion operations (or contraction if there is an excess of money offer).

Furthermore, strengthening cash flows forecasting capacities is essential if the Treasury wants to implement a more active cash management. For example, the Central Bank could be reluctant to agree on Treasury’s implementation of repo operations with the market or direct investment in deposits in commercial banks, if the cash flows forecasts are not sufficiently accurate.

B. Recommendations
1. In order to improve the coordination between monetary policy, debt and cash management, it is important to reduce Treasury’s cash flows volatility. This implies work to further strengthen cash flows forecasting and optimize the cash management strategy.
2. Volumes of T-Bills issuance could be further increased.
3. The DGCPTN could envisage gradual modifications in the domestic debt issuance strategy (see section 5) to further smooth debt redemption profile and reduce volatility of the National Treasury Deposits in the Central Bank. Indeed, large debt redemption payments on a specific day
generate a cost of carry for the Treasury. There is a need to investigate further on possible measures to reduce this cost of carry.

4. The liquidity buffer used by the Treasury to cope with Cash flows forecasts errors was set up long time ago according to criteria that might be obsolete. There is a need to investigate to see if the liquidity buffer is still appropriate.

5. The Ministry could create a Cash Coordination Committee (Sub-committee of the Treasury Committee) to review the latest cash flow forecasts and decide on preventive action.

C. Possible additional technical assistance

Strengthening cash flows forecasting and optimizing cash management strategy should be considered as a priority for the DGCPTN. Coordination of cash management with the debt management strategy could be further improved notably to reduce current cost of carry arising from the accumulation of reserves to deal with concentration of debt redemption on specific days. Furthermore, coordination of cash and debt management with the implementation of monetary policy could be further reinforced to develop local money market and allow Treasury to put in place an active cash management.

Further technical assistance could be considered. The action plan prepared by the World Bank identifies 4 main areas of work:

1. Improve cash flows forecasting;
2. Develop liquidity buffer;
3. Increase efficiency of safety nets and improve policies related to third parties’ funds administrated by the Treasury; and
4. Implement active cash management.

It is worth noting that assistance should not only focus on improving cash management strategy, but also on further linking it to the debt management strategy.
3. Capacity and Management of Internal Operations

This section of the program was focused on the structure reorganization of the DGCTPN. At the beginning of the program, the General Directorate was composed of nine Deputy Directorates (170 employees) assuming many other responsibilities than those typical of a debt management office. For instance, the DGCTPN was responsible to evaluate public enterprises corporate governance and risks associated with Public Private Partnerships.

In 2016, the Ministry introduced several modifications to the organizational structure of the DGCTPN, following suggestions of the World Bank team. The Ministry created a separate General Directorate of State Holdings, outside the DGCTPN, and a new Deputy Directorate in charge of management of PPPs.

This will help DGCTPN to refocus on its core business, namely government debt and cash management, in order to further improve its performance in this area.

However, DGCTPN still has a fragmented organizational structure that complicates coordination between Deputy Directorates and makes the managerial span of the Director challenging. Two proposals made by the World Bank team, namely the creation of a unique Front-Office and the appointment of a Deputy Director General, could be considered in future changes in the organizational structure of the DGCTPN.

Although part of the original program in this area has been integrated in an internal project of the DGCTPN to consolidate its information technology system and part of that put on hold, important outcomes were also achieved, such as (i) the reorganization of the DGCTPN with the creation of the General Directorate of State Holdings outside the DGCTPN and the Deputy Directorate of PPPs; (ii) the revision of the Mission, Vision and objectives of the DGCTPN, as well as a proposal for a new Business Model; and (iii) the development of the market risk manual and the book on the formulation of the debt management strategy.

A. Progress made by March 2016

Table 3 below shows the activities of the program and outcomes obtained by the DGCTPN in its reorganization process, as well as the products delivered by the World Bank during the technical assistance.

Table 3. Progress made in strengthening the organizational structure of the DGCTPN

<table>
<thead>
<tr>
<th>TOPICS</th>
<th>MAIN ACTIVITIES</th>
<th>OUTCOMES</th>
<th>PRODUCTS DELIVERED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revision of the internal organization</td>
<td>The GDRM Program has coordinated its activities with the Ministry’s internal project (Subcomponent 4.2 – Strengthening DGCTPN). Review of the organizational structure of the DGCTPN and recommendations to modify its structure. A local consultant specialized in reorganization of public entities has been hired by the MHCP from October to December 2014 to facilitate DGCTPN discussions on this topic.</td>
<td>Creation of the General Directorate of State Holdings (Direccion General de Participaciones Estatales) outside the DGCTPN.</td>
<td>Proposal for an organizational restructuring of the DGCTPN.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Creation of the Deputy Directorate of PPPs.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Revision of the Mission, Vision and objectives of the DGCTPN.</td>
<td></td>
</tr>
</tbody>
</table>
The World Bank team provided assistance to this consultant and participated in the discussions on the reorganization process. World Bank Resident Advisor participated in the Retreats/Seminaries organized by the DGCPTN. The World Bank team commented on outcomes of the Retreats/Seminaries. Videoconferences with the Mexican and the Brazilian Treasuries.

Proposal for a new Business Model for the DGCPTN.

**Recruitment, training plans for staff and change management.**

This topic was integrated to the Subcomponent 4.2. A Consulting Firm was supposed to implement a module on Human Resources Management as part of the new Business Model of the DGCPTN, which has been put on hold until further notice.

**Business processes and manuals of procedures.**

This topic was integrated to the Subcomponent 4.2. In 2013, a consulting firm (Ernst & Young) was hired to undertake an audit of current business processes of the DGCPTN. Another Consulting Firm was supposed to implement the new business processes as part of the new Business Model of the DGCPTN, which has been put on hold until further notice.

DMS book published (available on website).


The main outcome of the reorganization of the DGCPTN was to refocus the General Directorate on its core activities (government debt and cash management) and remove all the responsibilities associated with the management of State holdings, which is now in the hands of a new General Directorate (*Direccion General de las Participaciones Estatales*) created by the Ministry in 2016.

Furthermore, following the World Bank team’s proposal, the DGCPTN created a new Deputy Directorate in charge of Public Private Partnerships (PPPs), thus allowing the Risk Deputy Directorate (Risk Unit) to focus on treasury and public debt management.

Finally, the Investors Relations Deputy Directorate has been integrated to the External Financing Unit. As shown in the figure 1 below, the DGCPTN is now composed of 8 Deputy Directorates.

In December 2013, the MHCP hired a project manager, Mr. Juan Camilo Villamizar, to organize and follow up the activities of a specific component (Subcomponent 4.2 – Strengthening of the DGCPTN) of an internal project to consolidate information systems in the MHCP (CSNI project), financed by a World Bank loan. The Subcomponent 4.2 aimed at redefining completely the Business Model of the DGCPTN. The GDRM Program coordinated its activities with the Subcomponent 4.2 to avoid duplications of tasks, and some activities originally planned to be undertaken under the GDRM umbrella were moved to the DGCPTN’s internal project.
The first step of the redefinition of DGCTPN’s Business Model has been completed. Indeed, a local consultant, Mr. Alvaro Jaramillo, was hired by the Ministry from October 2014 to December 2014 to make a proposal for a new Business Model, which has been submitted to the Director of the DGCTPN at the end of the local consultant’s mandate.

The World Bank team supported the DGCTPN during all this process, notably by:

- Reviewing Terms of Reference to hire the local consultant;
- Participating to the workshops on the reorganization process with Deputy Directors and key staff of the DGCTPN;
- Providing presentations on organizational structure of others National Treasuries, reference documents and advise;
- Organizing videoconferences with the Mexican and Brazilian Treasuries, and with World Bank Senior Experts;
- Organizing visits and presentations from the World Bank Treasury staff on typical functions of a debt management office;
- Coordinating with IMF missions in the area;
- Participating to the 2 seminaries (days of Retreat of the DGCTPN) organized by the local consultant with the Director and Deputy Directors of the DGCTPN;
- Commenting on the results of those seminaries and advising the project manager and the local consultant based on international sound practices;
- Discussing with DGCTPN staff, local consultant and project manager previous diagnostics realized by the World Bank and the IMF to reorganize the DGCTPN.

The second step of the project consisted in hiring a consulting firm to implement this new business model, but the proposal for a new business model has not been formally approved. It has been put on hold until further notice due to budget restrictions. CSNI project and Subcomponent 4.2 ended in 2015.
Regarding recruitment, training plans for DGCPTN staff and the review of business processes and procedures manuals, these activities were integrated to the internal project of the Ministry (Subcomponent 4.2) to avoid duplications. As the proposal for a new business model has not been implemented, these activities are on hold. However, DGCPTN managed to achieve 3 major outcomes, namely the publication of the debt management strategy book, and the development and approval of two procedures manuals.

**B. Recommendations**

Numerous recommendations were made, between 2011 and 2014, both by the World Bank Treasury and the IMF to improve the organizational structure of the DGCPTN, and a detailed discussion on the reorganization of the Directorate can be found in the reports\(^1\) that were delivered.

As explained above, several recommendations have been introduced and allowed the refocusing of the DGCPTN on its core business activities. However, the reorganization could be further enhanced – regardless of approval of the new business model and hiring of a consulting firm – and the following recommendations could be addressed:

1. The DGCPTN should develop an operational risk manual to mitigate operational risks. Considering that the Risk Unit’s functions have been partially refocused on its core business, this unit should take the lead on the development of this manual with the help of other Deputy Directorates. The Risk Unit already started to work on it in close coordination with the Treasury and the Back Office.

2. The Risk Unit started discussing a methodology for managing liquidity risk. Based on Basel III guidelines, the Risk Unit established a Liquidity Cover Ratio (LCR) to measure how high liquidity assets are covering net cash outflows over a specified period. Next step could be a peer review of the work done and validation for its formal use.

3. Current infrastructure does not allow the Treasury to have a more active management of the portfolios administrated by the DGCPTN. Information systems are not up to date; they would hardly allow a significant increase in the volumes of transactions of the DGCPTN.

4. In order to improve efficiency of DGCPTN operations, and coordination between debt and cash management, the DGCPTN could consider merging the various Deputy Directorates in charge of financing government needs in one single Front Office.

5. In order to reduce Director’s managerial span, the appointment of a General Deputy Director could be considered.

**C. Possible additional technical assistance**

Potential areas for further TA include the validation of the liquidity risk model and the operational risk manual, as well as building capacity on risk and portfolio management. Activities could include:

- World Bank webinars on liquidity risk management to peer review the methodology used by the Risk Unit to measure liquidity risk;
- Trainings on credit risk management for the Risk Unit staff;
- Trainings on portfolio management for Treasury staff and on treasury operations for the Back Office staff;
- World Bank support to peer review operational risks manual.
4. Elaboration of the Medium-Term Debt Management Strategy (DMS)

Public debt management is the process of establishing and executing a strategy for managing the government’s debt in order to raise the required amount of funding at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk. It should also meet any other public debt management goals the government may have set, such as developing and maintaining an efficient market for government securities.

In 2013, the DGCPTN published its manual on the medium term debt management strategy (DMS). In doing so, the Ministry created the guidelines for administrating Central Government Public Debt under a risk management framework. Thus, by issuing the first formal medium-term debt management strategy for Colombia, the DGCPTN showed technical capacity to undertake risk analysis and substantially increased governance, accountability and transparency of public debt management operations, consolidating a remarkable outcome. Besides, in the process of developing and implementing the strategy, outcomes also included the development and documentation of an analytical model and the improvement on public debt management reporting.

It is worth noting that the DMS established in 2013 (for the period 2013-2017) targeted a debt portfolio composed of 75% of domestic debt and 25% of external debt. This strategy proved to be quite resilient in 2015 to face emerging markets turmoil and domestic market confirmed its capacity to absorb external shocks. This is certainly a major achievement in terms of strengthening public debt management and reducing vulnerability to financial shocks.

However, the DMS should be revisited in light of structural changes in the economy, notably a medium-term revision of key macroeconomic variables. In this process, the concepts in developing a DMS – namely the cost-risk tradeoffs and interactions with the macroeconomic policy and the degree of domestic market development - should be reinforced and reporting on the implementation of the DMS should be further developed. Sound debt management requires regular revisions of the medium-term DMS.

A. Progress made by March 2016

Table 4 below shows the activities of the program and outcomes obtained by the DGCPTN to elaborate a debt management strategy, as well as the products delivered by the World Bank team during the technical assistance.

Table 4. Progress made in the elaboration of the MTDS

<table>
<thead>
<tr>
<th>TOPICS</th>
<th>MAIN ACTIVITIES</th>
<th>OUTCOMES</th>
<th>PRODUCTS DELIVERED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Update and Improvement to the Debt Cost at Risk Model</td>
<td>Improvement in the Cost-at-Risk methodology used by the DGCPTN and documentation of that in the DMS book. Strengthening of the ALM approach used by the DGCPTN. Review of inputs and outputs of the Model.</td>
<td>Cost-at-Risk Model developed and documented.</td>
<td>DMS book explains the methodology used by the Cost-at-Risk Model.</td>
</tr>
</tbody>
</table>

Design and review of the medium-term Debt Management Strategy (DMS) and creation of an Annual Borrowing Plan

- Support in the writing and publication of the DMS book.
- Support in the improvement of debt and cash management reporting.
- Elaboration of the first quarterly report on compliance with MTDS.
- Elaboration of the first draft of the new Annual Debt report.
- Creation of a Working group (comprised of 2 Risk Unit officers, 1 Domestic Debt Unit officer and WB Resident Adviser) to establish a proposal of reporting on the DMS and Annual Borrowing Plan.
- Survey and interviews with all the Deputy Directors on the review of the DMS, Annual Borrowing Plan and Debt reporting.
- Presentation of the proposal on the design and periodic review of the DMS and Annual Borrowing Plan.
- Medium-Term Debt Management Strategy proposed by the Risk Unit and approved and published by the Finance Minister in 2012.
- Annual Debt Report published in the Ministry Website.
- Draft of a quarterly report on compliance with the DMS.
- Survey on the DMS, Annual Borrowing Plan and Debt reporting.
- Presentation to the Director for reporting on the DMS and Annual Borrowing Plan.
- Review of the DMS book.
- Written comments on draft report on compliance with the DMS.
- Note on links between the DMS, MTFF, Government Financial Plan and the annual budget process in Colombia.

**Improvements to the Cost-at-Risk Model**

Quantitative models for the design of the debt management strategy were developed and documented. A Cost-at-Risk Model is now in place to design the debt strategy and this was one of the two key indicators for this section of the GDRM Program.

The Cost-at-Risk methodology has been further developed. The Risk Unit obtained more detailed projections of key macroeconomic and markets variables (primary balance, GDP, inflation, interest rates, and exchange rates) from the General Directorate of Macroeconomic Policy. These projections are used as inputs of the Model. The Cost-at-Risk model also uses inputs from financial information providers; these inputs are uploaded in excel spreadsheets that source MATLAB software to run simulations. The methodology is detailed in the DMS publication.

Another important change was to include promissory notes issued by the National Treasury (*Pagares*) in the simulations of the model. In including these instruments, the model widened its ALM approach and allowed DGCPTN to have a better view of reasons that could eventually generates deviations from the established medium-term strategy.

**Review of the DMS, Annual Borrowing Plan and Debt Reporting**

The second key indicator for this component of the GDRM program has been achieved as well. Indeed, DGCPTN prepares, reviews and implements a formal debt management strategy. One of the main achievements of the program is probably the publication of the DMS book, which was approved by the...
Finance Minister, and allowed the formalization of the DMS framework and the strengthening of DGCPTN’s institutional memory.

However, the process of reviewing the DMS could be further developed. In the first semester of 2014, the Risk Unit produced a first draft of a quarterly report on the compliance with the DMS. This draft still needs further technical improvements. Indeed, some concepts related to the DMS could be reviewed. For instance, the strategic benchmarks (such as the 75% of domestic debt in the portfolio) are not really being considered in the design of the financial plan. Thus, the medium-term composition of the debt portfolio is being extrapolated from the financial plan, instead of being based on the DMS and driving the elaboration of the annual plan.

Regarding the improvement on debt reporting, the DGCPTN started publishing an annual debt report on the website of the Ministry. An annual report used to be published before 2011, but it was abandoned for several years, before being resumed in 2015.

This annual debt report is very informative and descriptive. Facts and figures are instructive and analysis is kept to the minimum. There is no section on compliance with debt strategy, because DGCPTN decided to prepare a separate quarterly report on this topic. A template for a more comprehensive and analytical annual report was prepared in 2014 by the Domestic Debt Unit with inputs from other DGCPTN’s units. Next step could be to apply the new version of the annual debt report for the year 2016.

Finally, the DGCPTN started publishing an auction calendar in the website of the Ministry. This auction calendar is a time schedule of all the auctions that will be realized during the next year, including which government securities will be issued in each auction (benchmarks are 5,10 and 15 years for bonds denominated in pesos and 5, 10 and 20 years for bonds denominated in UVR). However, the calendar does not give any information on the amounts to be issued, not even indicative amounts or caps. Furthermore, the Domestic Debt Unit prepares this calendar according to its issuance strategy, but not necessarily in full accordance with the DMS. Therefore, there is the need to develop a more comprehensive annual borrowing plan, fully in line with the medium-term DMS.

**B. Recommendations**

1. A comprehensive annual debt report is generally the vitrine of a public debt management office, as it details the debt management operations. It should include a section to report on the compliance with the DMS and the annual borrowing plan. The template prepared in 2014 could be reviewed and approved in order to replace the current annual report published in the website.

2. The Annual Borrowing Plan could be further developed by further integrating the issuance strategy with the medium-term DMS, rather than the current practice where the issuance schedule and the choice of securities to be issued are fixed inputs of the model used to determine the medium-term benchmarks.

3. The quarterly report on the compliance with the DMS could be strengthened. Internally, this report could be prepared on a quarterly basis, but a public version could be issued twice a year on the Ministry website.
4. The ALM approach used by the quantitative model could be further developed by integrating the debt management strategy with the cash management strategy. For instance, the Treasury Unit is currently looking at Cash flows requirements and fills the gap with issuance of Promissory Notes (Pagares). But, the decision to issue Promissory is not integrated with the domestic debt issuance.

5. The Financial Plan gives inputs to the definition of medium-term benchmarks, but recommendations of the DMS are not really considered in the design of the financial plan. The relation between the MTDS and the Financial Plan could be more dynamic, with benchmark targets of the DMS driving the establishment of the Financial Plan, along with the short term restrictions (market demand etc.).

6. A written service level agreement between Deputy Directorates that participates in the design and monitoring of the DMS should be considered so as to formalize the process.

7. The DMS should be periodically reviewed, particularly in light of structural changes in the economy. External factors such as persistently low international oil prices and depreciated exchange rate against USD may imply changes in the medium-term strategy. However, the DGCTPN should be careful not to increase the opportunistic behavior of the front-offices and, as a consequence, transforming the DMS in a pure theoretical exercise. Medium-term targets (benchmarks) of the strategy should not be mixed up with tactical portfolio rebalancing.

C. Possible additional technical assistance

Further support on the development and implementation of a medium-term strategy aiming at further improvements, as mentioned above, was discussed with authorities and could potentially include activities such as:

- A workshop on developing a medium-term DMS with key staff of the DGCPTN, the General Directorate of the Macroeconomic Policy and the General Directorate of the Budget could be organized to reinforce DMS’ concepts and strengthen the process to review the DMS.
- The DMS workshop could support the DGCTPN in the preparation of an annual borrowing plan for 2017.
- After the DMS workshop, the World Bank could support the DGCTPN in the preparation of a new DMS document for the period 2017-2021.
- The World Bank could support the DGCTPN in peer reviewing the new annual debt report.
5. Development of the Domestic Debt Market

As mentioned in the previous section, the development of the domestic debt market proved to be an important element to reduce the vulnerabilities of the economy to external financial shocks, such as the emerging markets turmoil experimented in 2015.

The Ministry of Finance put in place important measures to deepen the domestic government bond market. The main outcomes were the broadening and diversification of the investor base for government bonds through an increase of foreign investors participation in the government securities market – foreign investors represented less than 6% of Treasury Bonds holders in 2011, but reached 18% in 2015 – and improved efficiency of the yield curve in pesos with the reintroduction of a T-Bills program that created reference securities in the short-end of the curve and helped the Treasury to strengthen its management of cash balances.

Additionally, the Central Bank decided to abandon its issuance of securities for monetary control purposes, allowing a more consistent issuance of government securities made by a unique issuer (the Treasury) with a single strategy.

Several suggestions made by the World Bank team were applied by the Ministry to improve current functioning of the Colombian domestic debt market, which was already a relatively well-developed market. Other recommendations – proposed modifications to the Primary Dealers Program, to the issuance strategy and creation of a securities lending facility (SLF) – are being either evaluated or in initial phase of implementation (SLF).

A. Progress made by March 2016

Table 5 below shows the activities of the program and outcomes obtained by the DGCPTN with the module dedicated to the development of the domestic debt market, as well as the products delivered by the World Bank team during the technical assistance.

<table>
<thead>
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The purpose of the present report is not to make an assessment of the Colombian domestic capital market, but simply to list progress made in the deepening of the market compared to the situation at the beginning of the GDRM program. This component was implemented with support from the Finance and Markets (F&M) Global Practice team of the WB, who worked closely with the WB Treasury.

**Primary Dealers Program**

In 2014, the WB team prepared an aide-mémoire with suggestions to modify several provisions of the Primary Dealers Program. The focus was on the non-competitive subscriptions (NCS) of Treasury Bonds, which differ considerably from international standards. Notably, the period to exercise the option to buy government securities is unusually long (12 days) and the NCS allocation very high (PDs can buy up to 100% of the amount issued in the competitive auction).

However, the privilege obtained by the PDs in the NCS round tends to result in more aggressive bids in the primary auction and, thus, facilitate the placement of government securities in the first round. Any modification in the NCS must be carefully evaluated, because it could generate resistance from PDs and be counterproductive for the government.

At the moment, DGCPTN has decided to keep current rules of the Primary Dealers Program unchanged. But, it might undertake further analysis of the costs/benefits of potential modifications to the PDs program.

**Issuance Program and Liability Management Operations (LMOs)**

DGCPTN made a major debt switch with the market in 2014 and, since then, many smaller internal liabilities management operations (LMOs) between the Treasury and the Domestic Debt Unit. These LMOs resulted in improving debt profile, by extending average life and diminishing TES maturity concentration in specific periods.

The debt switch with market participants have the advantage to increase liquidity of securities in the secondary market and reduce refinancing risk. However, it comes with a cost for the government. Usually, the operation is announced to the market several days before, which can generate some volatility in the prices of Treasury bonds exchanged until the debt switch auction date. Currently, there is no standardized
agreement between the Ministry and market participants for debt switch operations, which tends to add a day or two from the announcement date until the auction date to allow legal departments to review the operation. At this time, there is not a systematic approach to using LMOs, and announcements are made *ad-hoc*.

DGCPTN introduced a new issuance program in 2012 with the goal of deepening the government securities market through a more systematic benchmark building strategy. The new program was well received by the investors and certainly contributed to increase the liquidity of the Treasury Bonds market.

However, the Domestic Debt Unit considers that the strategy could be enhanced in order to further smooth the debt portfolio redemption profile and also avoid years with smaller reimbursement amounts such as 2017 or 2019. This last point can be partially tackled with the recently reintroduction of the T-Bills program.

**Diversification of the Investor base**

The main outcome of this component was the increase of foreign investors holding of Treasury Bonds from less than 6% in 2011 to 18% in 2015. The diversification of the investor base plays a critical role in reducing demand risk (refinancing risk) and promoting market development.

Between 2012 and 2014, Colombian authorities took several measures that generated an increase in foreign investors’ participation in the Colombian domestic market, notably the reduction to 14% in the tax rate applied to off-shore investors (25% for tax-heaven countries) and the change in the burden of administrative and reporting tasks required by law, which can be completed now by the local representative instead of the foreign investor.

Financial institutions still demand additional efforts in simplifying regulations to facilitate foreign investment. For instance, they consider that additional measures could be taken in order to improve the legal framework to facilitate foreign investments, such as eliminating the financial transaction tax or allowing TES to be Euroclearable.

It must be said that, in 2014, JP Morgan decided to increase the weight of Colombia in its Benchmark Emerging Market Portfolio index, which provoked inflows of foreign funds to the domestic capital market and pushed foreign investors’ participation to 15%.

**Securities Lending Facility (SLF)**

Although a Securities lending facility has not been implemented so far, distortions of the yield curve for government securities were reduced for several reasons, notably the reintroduction of T-Bills, debt buybacks and debt switches performed by the Treasury, and the greater diversification of investors participating to the government securities market.

In 2013, the Ministry decided to implement a SLF to reduce imbalances between the supply and demand of specific benchmark securities due to the behavior of Pension Funds that were cornering the market (security squeezes). Since then, these distortions on specific points of the yield curve diminished
significantly. Nevertheless, the creation of a Securities Lending Facility would provide another way to add liquidity to the government securities market and develop the repo market.

DGCPTN is exploring the possibility for the Ministry to act as lender of last resort by creating a SLF where the required TES references could be temporarily created and lent via the SLF of the Central Bank which has only been used once in 2009. The World Bank will be providing support for the implementation of the SLF, through the Finance and Markets Global Practice.

Specific support will include (i) the regulatory changes needed to allow the DGCPTN to create temporarily reference securities, and (ii) detailed features of the SLF, like price setting, limits to the creation of securities or potential counterparts.

*Coordination of primary issuance with monetary policy*

The main outcome of this component was the reintroduction of the T-Bills program and the Central Bank decision to abandon the issuance of securities for monetary control purposes. It created reference securities in the short-end of the curve, which are essential for the accurate pricing of other financial instruments (i.e. corporate bonds), and thus the efficient allocation of capital in the financial market.

Several discussions took place between the Domestic Debt Unit of the DGCPTN and the Monetary Operations Department of the Central Bank (*Subgerencia Monetaria y de Inversiones Internacionales*), with support from the World Bank. Conclusions were that primary issuance of government securities was fragmented with the Central Bank taking care of short-term instruments and the Ministry of Treasury Bonds. In line with the World Bank team recommendations, the Central Bank and MHCP decided to take action as explained in the precedent paragraph.

Other recommendations were made to reduce the volatility of the Treasury account at the Central Bank and smoothing the amortization profile through liability management operations. As explained in section 2, this would be beneficial to develop local money market. The suggestions were well received by the DGCPTN which integrated them to the future work on optimizing the cash management strategy.

**B. Recommendations**

1. For debt switch operations, a master agreement could be signed between the Ministry and markets participants. This would simplify legal procedures and reduce the time period between the debt switch announcement date and auction date. This could be useful, especially in times of high volatility when debt switches are difficult to execute.

2. DGCPTN could also consider the design of a systematic LMO program, in line with the debt management strategy, in order to increase predictability for market participants. In this program, the Ministry could keep the right to execute the operation at the date scheduled. This could further improve the government debt profile by diminishing TES maturity bunching in specific periods and increasing liquidity in the secondary markets.
3. The introduction of a Security Lending Facility remains a priority to counter collateral deficiencies in repo operations. This would be an important step in the development of the money market in Colombia. It can also further reduce potential collusion in the secondary market, in case some market participants try to corner market prices by restricting lending of paper for arbitrage.

C. Possible additional technical assistance
As said before, the WB is already providing assistance to the authorities in the implementation of a Securities Lending Facility. Other areas that were discussed with the authorities as priorities and where the WB could provide further assistance are:

- Establishment of a programmatic approach to LMOs.
- Revisiting the issuance strategy and its integration with the overall debt management strategy.

6. Next Steps
A second phase of the GDRM program is being discussed by the World Bank with SECO and other potential donors and may be in place in the medium-term (2017). Under the second phase, the program could support Colombia in implementing other debt management reforms as discussed with authorities and highlighted in this report.