Appendix 1. Specific Financial Instruments and Transactions: Classification

The purpose of this appendix is to provide detailed information on specific instruments and transactions and to set out their classification treatment in the gross external debt position. There are two sections. The first provides a description of specific financial instruments and how they should be classified in the gross external debt position; the second sets out the classification treatment of some specific transactions that, experience suggests, require particular clarification.

Part 1. Financial Instruments: Description and Classification in the Gross External Debt Position[1]

A

American Depository Receipt (ADR)

An ADR is a negotiable certificate that represents ownership of the securities of a non-U.S. resident company. Although the securities underlying ADRs can be debt or money market instruments, the large majority are equities. An ADR allows a non-U.S. resident company to introduce its equity into the market in a form more readily acceptable to investors, such as in U.S. dollars, without needing to disclose all the information normally required by the U.S. Securities and Exchange Commission. A U.S. depository bank will purchase the underlying foreign security and then issue receipts in dollars for those securities to the U.S. investor. The receipts are registered. The investor can exchange the ADRs for the underlying security at any time. See also *Bearer Depository Receipts* and *Depository Receipts*.

Classification

These instruments are classified by the nature of the underlying instrument backing the ADR. This is because the “issuing” intermediary does not take the underlying security onto its balance sheet but simply acts as a facilitator. So, the debtor is the issuer of the underlying security, i.e., an ADR is regarded as a non-U.S. resident issue. If owned by nonresidents, these instruments are to be included in the gross external debt position if the underlying security is a debt security. The security is classified as *short-term/long-term, debt securities* (*portfolio investment, debt securities* in the IIP) or, depending on the relationship between debtor and creditor, as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). If the underlying item is an equity investment, it should be classified in the memorandum table, *equity liability position with nonresidents by sector* (Table 4.5) under the appropriate institutional sector. If the nonresident is in a direct investment relationship with the issuer, then the equity is classified as *direct investment: equity and investment fund shares* (Table 4.5).

Arrears

Amounts that are past due-for-payment and unpaid. These include amounts of scheduled debt-service payments that have fallen due but have not been paid to the creditor(s).

In the context of the Paris Club, arrears are the unpaid amounts that fall due before the consolidation period. See *Paris Club, Creditor,* and *Consolidation Period* in Appendix 3.

Arrears also include amounts related to other non-debt-instruments and transactions such as, a financial

[1]This appendix has drawn significantly upon the Bank of England (1998), *Financial Terminology Database*, and *BPM6*, Chapter 5.

derivatives contract that comes to maturity and a required payment is not made, or when goods are supplied and not paid for on the contract payment date, or a payment for goods is made but the goods are not delivered on time.

Classification

Arrears of principal and/or interest are reported in the original debt instrument. If owned by nonresidents, the debt instruments are to be included in the gross external debt position.

Arrears related to other nondebt-instruments and late payments of nondebt transactions are debt liabilities that should be recorded under the appropriate instrument, i.e., either *trade credit and advances* or *other debt liabilities* in the gross external debt position (*other investment*, either *trade credit and advances* or *other accounts receivable/payable-other* in the IIP).

Asset-Backed Securities

Asset-backed securities are bonds whose income payments and principal repayments are dependent on a pool of assets. Securities may be backed by various assets, e.g., mortgages, credit card loans, and automobile loans, in effect, converting illiquid assets into negotiable securities. The security issuers have a requirement to make payments, while the holders do not have a residual claim on the underlying assets. An asset-backed security enables the original lending institution to devolve credit risks to investors. There are several key features of asset-backed securities: the original lender will usually sell the assets to a trust or other form of intermediary (special purpose vehicle) and so, in the case of a bank, this frees "capital" that regulatory guidelines require a bank to hold against the assets. The intermediary will finance the purchase of the assets by issuing securities. Because income and the repayment of principal are dependent on the underlying assets, if the underlying assets are prepaid so is the security. Issuers often provide different tranches of the security so that if there are prepayments, the first tier will be repaid first, the second tier next, etc. The pricing of the various tranches will reflect the probability of early repayment. Asset-backed securities have also been developed that securitize future income streams—such as the earnings of musicians.

Classification

Asset-backed securities owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term*, *debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). These securities present a special problem regardless of the amount outstanding because there can be partial repayments of principal at any time. Therefore, simply revaluing the original face value to end-period market prices will cause overvaluation of the position data if there has been a partial repayment.

B

Balances on Nostro and Vostro Accounts

A vostro (your) account is another bank's account with a reporting bank, while a nostro (our) account is a reporting bank's account with another bank.

Classification

Liability positions in nostro and vostro accounts are to be included in the gross external debt position. They are classified as deposit-taking corporations, except the central bank, *short-term, currency and deposits,* or *loans* (*other investment* in the IIP) depending on the nature of the account.

Bankers' Acceptances

A negotiable order to pay a specified amount of money on a future date, drawn on and guaranteed by a financial corporation. These drafts are usually drawn for international trade finance purposes as an order to pay an exporter a stated sum on a specific future date for goods received. The act of a financial corporation stamping the word "accepted" on the draft creates a banker's acceptance. The acceptance represents an unconditional claim on the part of the owner and an unconditional liability on the part of the accepting financial corporation; the financial corporation's counterpart asset is a claim on its customer. Bankers' acceptances are treated as financial assets from the time of acceptance, even though funds may

not be exchanged until a later stage. By writing the word "accepted" on the face of the draft the bank carries primary obligation, guaranteeing payment to the owner of the acceptance. Bankers' acceptances can be discounted in the secondary market, the discount reflecting the time to maturity and credit quality of the guaranteeing bank. Since the banker's acceptance carries a financial corporation's obligation to pay (in effect "two-name paper") and is negotiable, it becomes an attractive asset. Bankers' acceptances are always sold at a discount and usually have maturities of up to 270 days.

Classification

Bankers' acceptances are short-term debt securities that are claims on the accepting financial corporation, with the financial corporation owning a claim on the issuer of the bill.

If owned by nonresidents, bankers' acceptances should be included in the gross external debt position. They should be classified as *short-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of over one year, in which instance they are to be classified as *long-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment; Intercompany lending* (see the description of *direct investment* in Chapter 3).

Bearer Depository Receipt (BDR)

A form of depository receipt issued in bearer rather than registered form. See *Depository Receipts*.

Classification

A BDR is classified according to the nature of the underlying instrument backing it. This is because the "issuing" intermediary does not take the underlying security onto its balance sheet but simply acts as a facilitator. So, the debtor is the issuer of the underlying security. If owned by nonresidents, these instruments are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *direct investment; intercompany lending* (see the description of *direct investment* in Chapter 3).

Bonds with an Embedded Call Option

A bond that gives the issuer a right to buy back the bonds on or by a particular date. The value of this right is usually reflected in the interest rate on the bond.

Classification

Bonds with embedded call options owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Bonds with an Embedded Put Option

A bond whereby the creditor has the right to sell back the bonds to the issuer on or by a particular date, or under certain circumstance, such as a credit downrating of the issuer. This right is usually reflected in the interest rate on the bond.

Classification

Bonds with embedded put options owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). The option is regarded as an integral part of the bond and is not separately valued and classified.

Brady Bonds

Brady bonds, named after U.S. Treasury Secretary Nicholas Brady, arose from the Brady Plan. This plan was a voluntary market-based approach, developed in the late 1980s, to reduce debt and debt service owed to commercial banks by a number of emerging

market countries. Brady bonds were issued by the debtor country in exchange for commercial bank loans (and in some cases unpaid interest). In essence they provided a mechanism by which debtor countries could repackage existing debt. They are dollar denominated, "issued" in the international markets. The principal amount is usually (but not always) collateralized by specially issued U.S. Treasury 30-year zero-coupon bonds purchased by the debtor country using a combination of IMF, World Bank, and the country's own foreign currency reserves. Interest payments on Brady bonds, in some cases, are guaranteed by securities of at least double-A-rated credit quality held with the New York Federal Reserve Bank. Brady bonds are more negotiable than the original bank loans but come in different forms. The main types are as follows:

- *Par bonds*—Bonds issued to the same value as the original loan, but the coupon on the bonds is below market rate. Principal and interest payments are usually guaranteed
- *Discount bonds*—Bonds issued at a discount to the original value of the loan, but the coupon is at market rate. Principal and interest payments are usually guaranteed
- *Debt-conversion bonds*—Bonds issued to the same value as the original loan but on condition that "new" money is provided in the form of new-money bonds
- *Front-loaded interest reduction bonds*—Bonds issued with low-rate fixed coupons that step up after the first few years

There are also other, less common types.

Classification

Brady bonds owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP). When a Brady bond is issued, the original loan is assumed to have been redeemed unless the terms of the issue of the Brady bond state otherwise. Any debt reduction in nominal value terms should be recorded—see Chapter 8. The initial purchase of the principal collateral (U.S. Treasury bonds) is a separate transaction and is classified as debt of the United States.

C

Callable Bonds

A callable bond is a bond in which the bondholder has sold the issuer an option (more specifically, a call option) that allows the issuer to repurchase the bond from the time the bond is first callable until the maturity date.

Classification

Callable bonds owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Catastrophe Bonds

Catastrophe bonds (also known as cat bonds) are bonds whose principal and interest is forgiven in the event of a catastrophe. These bonds are typically issued by insurers as an alternative to selling traditional catastrophe reinsurance. If no catastrophe occurred, the insurance company pays a coupon (usually at a high rate given the risk inherent in the bond) to the investors. If a catastrophe occurs, the forgiveness of the bond supports the insurance company as it makes payments to its claim-holders.

Classification

Cat bonds owned by nonresidents are to be included within the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). If a catastrophe occurs, that is the event specified in the debt contract, forgiveness of principal and interest is recorded as debt forgiveness (see paragraph 8.11, footnote 6).

Certificate of Deposit (CD)

A certificate issued by a deposit-taking corporation acknowledging a deposit in that corporation for a specified period of time at a specified rate of interest; CDs are essentially a form of negotiable time deposit (evidenced by the certificate). Nevertheless, a small minority of CDs are known to be nonnegotiable—not negotiable. CDs are widely issued in the domestic and international markets, and are typically bearer instruments, issued at face value with original maturities of one to six months, although there have been maturities of up to seven years. Typically, interest costs are payable at maturity for issues of one year or less, and semiannually on longer issues. The rate of interest on a given CD depends on several factors: current market conditions, the denomination of the certificate, and the market standing of the bank offering it. Typically, CDs are highly liquid instruments, which allow banks access to a cheaper source of funds than borrowing on the interbank market.

Classification

CDs owned by nonresidents are to be included in the gross external debt position. Those with an original maturity of one year or less should be classified as *short-term, debt securities* (*portfolio investment, debt securities* in the IIP), while those with an original maturity of over one year should be classified as *long-term, debt securities*. However, nonnegotiable CDs that are owned by nonresidents are to be classified as *short-term, currency and deposits* (*other investment, currency and deposits* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Collateralized Debt Obligations (CDOs)

CDOs are bonds whose income payments and principal repayments are dependent on a pool of instruments. Typically, a CDO is backed by a diversified pool of loan and bond instruments either purchased in the secondary market or from the balance sheet of a commercial bank. The diversified nature of the instruments differentiates a CDO from an asset-backed security, which is backed by a homogeneous pool of instruments, such as mortgages and credit card loans. Issuers are often provided with different tranches of the security, so that if there are prepayments the first tier will be repaid first, the second tier next, etc. This allows investors to take different levels of credit risk. The pricing of each tranche reflects the probability of repayment.

Classification

CDOs owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term*, *debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). These securities present a special problem regardless of the amount outstanding because there can be partial repayments of principal at any time. Therefore, simply revaluing the original face value to end-period market prices will cause overvaluation of the position data if there has been a partial repayment.

Commercial Paper (CP)

Commercial paper (CP) is an unsecured promise to pay a certain amount on a stated maturity date, issued in bearer form. CP enables corporations to raise short-term funds directly from end investors through their own in-house CP sales team or via arranged placing through bank dealers. Short-term in nature, with maturities ranging from overnight to one year, CP is usually sold at a discount. A coupon is paid in a few markets. Typically, issue size ranges from $100,000 up to about $1 billion. In bypassing financial intermediaries in the short-term money markets, CP can offer a cheaper form of financing to corporations. But because of its unsecured nature, the credit quality of the issuer is important for the investor. Companies with a poor credit rating can obtain a higher rating for the issue by approaching their bank or insurance company for a third-party guarantee, or perhaps issue CP under a MOF (Multiple Option Facility), which provides a backup line of credit should the issue be unsuccessful.

Classification

Commercial paper owned by nonresidents is to be included in the gross external debt position. Such paper should be classified as *short-term, debt securities* (*portfolio investment, debt securities* in the IIP).

Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). When CP is issued at a discount, this discount represents interest income.

Commitment-Linked Repayment Loans

These loans have a schedule of principal repayments including a grace period based on the committed amount. The schedule of payment, which is usually shown in the loan agreement, is based on the assumption that the loan will be fully withdrawn. In cases of cancellation or enhancement of the committed amount, the schedule of repayments in the loan agreement is maintained but the repayment amounts are adjusted in line with the ratio between the new committed amount and the original committed amount. The actual principal repayments depend on the amount disbursed. Commitment-linked repayment loans will usually have one of the following principal repayment schedules: (1) annuity-type repayment; (2) bullet repayment; (3) straight-line repayment; and (4) custom-tailored repayment.

Classification

Commitment-linked repayment loans extended by nonresidents to residents are to be included in the gross external debt position as *loans* (*other investment* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these loans could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Commodity-Linked Bonds

A bond whose redemption value is linked to the price of a commodity. Typically, issuers whose income stream is closely tied to commodity earnings issue these bonds.

Classification

Bonds with payoffs linked to movements in commodity prices and owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Commodity-Linked Derivatives

Derivatives whose value derives from the price of a commodity. These include:

- *Commodity future*—traded on an organized exchange, in which counterparties commit to buy or sell a specified amount of a commodity at an agreed contract price on a specified date
- *Commodity option*—gives the purchaser the right but not the obligation to purchase (call) or sell (put) a specified amount of a commodity at an agreed contract price on or before a specified date
- *Commodity swap*—a swap of two payment streams, where one represents a currently prevailing spot price and the other an agreed contract price for a specified quantity and quality of a specified commodity

Net cash settlements are usually made.

Classification

Commodity-linked derivatives in which the counterparty is a nonresident are included indistinguishably in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Convertible Bonds

A convertible bond is a fixed-rate bond that may, at the option of the investor, be converted into the equity of the borrower or its parent. The price at which the bond is convertible into equity is set at the time of issue and typically will be at a premium to the market value of the equity at the time of issue. The conversion option on the bond may be exercised at one specified future date or within a range of dates—"the window period." The conversion right cannot be separated from the debt. The instrument allows the investor to participate in the appreciation of the underlying asset of the company while limiting risk. A convertible bond will generally pay a coupon rate higher than the dividend rate of the underlying equity at the time of issue but lower than the rate of a comparable bond without a conversion option. For the investor, the value of the

convertible bond lies in the excess return of the bond yield over the dividend yield of the underlying shares.

Classification

Convertible bonds owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). As bonds are converted into equity, so the debt is extinguished. The equity issued is recorded in the memorandum table, *equity liability position with nonresidents by sector* (Table 4.5), under the appropriate institutional sector. If the nonresident is in a direct investment relationship with the issuer, then the equity is classified as *direct investment: equity and investment fund shares* in the memorandum table (Table 4.5).

Covered Bonds

Covered bonds are dual-recourse bonds with a claim on the issuer and, if the issuer defaults, a cover pool of high-quality collateral (which the issuer is required to maintain). Covered bonds are issued under specific legislation (or contracts which emulate this). The recourse to the pool of collateral and consequent reduction in credit risk transfer distinguishes covered bonds from asset-backed securities.

Classification

Covered bonds owned by nonresidents are to be included in the gross external debt position of the economy of residence of the issuer of the covered bond. They should be classified as *long-term*, *debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). In case of default, a change of debtor and/or type of instrument may occur when the recourse to the pool of collateral is activated.

Credit Derivatives

Derivatives that provide a market in credit risk. Investors will use credit derivatives to gain or reduce exposure to credit risk. With a credit derivative the investor is taking a view on the creditworthiness of the issuer(s) of the underlying instrument(s) without necessarily risking principal (although credit derivatives may be embedded in a security). Credit derivatives take the form of both forward-type (total return swaps) and option-type contracts (credit default swaps). For instance, a creditor may lend to a debtor but wants to protect against the risk of default by that debtor. The creditor "buys" protection in the form of a credit default swap—the risk premium inherent in the interest rate is swapped by the creditor for a cash payment in event of default, i.e., in the event of default, the seller of a credit default swap is liable for "loss given default" (the magnitude of likely loss on the exposure if the borrower defaults). Also, these instruments are used to circumvent local investment rules, e.g., if a foreign investor cannot invest in equity securities and so enters into a total return swap where the foreign investor pays a reference rate, say LIBOR, against the total return—dividends and capital gain/loss—on an equity security. The other most common structure is a spread option whose payoff structure depends on the interest rate spread between emerging country debt and, say, U.S. Treasury bonds.

Classification

Credit derivatives in which the counterparty is a nonresident are included indistinguishably in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Credit Default Swap

A credit derivative option-type contract. A credit default swap (CDS) is a financial derivative whose primary purpose is to trade credit default risk. Under a CDS, premiums are paid in return for a cash payment in the event of a default by the debtor of the underlying instrument. See also *Credit Derivatives*.

Classification

Credit default swaps in which the counterparty is a nonresident are included indistinguishably in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Credit-Linked Note

A so-called structured security that combines a credit derivative and a regular bond. Credit-linked notes (CLN) are debt securities that are backed by reference assets, such as loans and bonds, with an embedded CDS allowing credit risk to be transferred from the issuer to investors. Investors sell credit protection for the pool of assets to the protection buyer (or issuer) by buying the CLN. Repayment of principal and interest on the notes is conditional on the performance of the pool of assets. If no default occurs during the life of the note, the full redemption value of the note is paid to investors at maturity. If a default occurs, then investors receive the redemption value of the note minus the value of the default losses.

Classification

Credit-linked notes owned by nonresidents are to be included in the gross external debt position of the issuer of the credit-linked note. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). The credit derivative is regarded as an integral part of the bond and is not separately valued and classified.

Currency

Currency consists of notes and coins that are of fixed nominal values and are issued and authorized by central banks or governments; notes and coins are in circulation and commonly used to make payments.

Classification

Domestic currency owned by nonresidents is included within the gross external debt position as *central bank* (or perhaps *deposit-taking corporations, except the central bank, or other institutional units*), *short-term, currency and deposits* (*other investment*in the IIP).

Currency-Linked Bonds

A bond in which the coupon and/or redemption value are linked to the movement in an exchange rate. Examples of these types of bonds were the *tesobonos* issued by Mexican banks in 1994. These bonds, issued and payable in pesos, had a redemption value linked to the movement in the U.S. dollar/Mexican peso exchange rate. When the Mexican peso depreciated, the redemption value increased. More recent examples include currency-linked bonds issued by Brazilian federal government in late 1990s and until mid-2000s—see BIS Quarterly Review, June 2007—Jamaica, Philippines, Thailand, Malaysia, Indonesia, India, and the World Bank—for instance, a samurai bond with a foreign exchange linked variable coupon.

Classification

Bonds with payoffs linked to movements in exchange rates and owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Currency Pool Loans

Currency pool loans, provided by the World Bank and regional development banks, are multicurrency obligations committed in U.S. dollar-equivalent terms whose currency composition is the same (pooled) for all borrowers.

Classification

Currency pool loans of the borrowing economy are to be included in the gross external debt position. They should be classified as *loans* (*other investment* in the IIP).

D

Debt Securities

Debt securities are negotiable instruments serving as evidence of a debt. They include bills, bonds, notes, negotiable certificates of deposit, commercial paper, debentures, asset-backed securities, and similar instruments normally traded in the financial markets. Bills are defined as securities that give the holders the unconditional rights to receive stated fixed sums on a specified date. Bills are generally issued at discounts to face value that depend on the rate of interest and the time to maturity and are usually traded

in organized markets. Examples of short-term, debt securities are treasury bills, negotiable certificates of deposit, bankers' acceptances, promissory notes, and commercial paper. Debt securities give the holders the unconditional right to fixed or contractually determined variable payments (i.e., earning of interest is not dependent on earnings of the debtors). Depository receipts, whose underlying securities are debt securities, are debt securities.

Classification

Debt securities owned by nonresidents are to be included in the gross external debt position. Debt securities should be classified as *long-term, debt securities*, if issued with an original maturity of over one year, or as *short-term, debt securities*, if issued with an original maturity or one year or less (*portfolio investment, debt securities* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Deep-Discount Bond

A bond that has small interest payments and is issued at a considerable discount to its par value. See also *Zero-Coupon Bonds*.

Classification

Deep-discount bonds owned by nonresidents are to be included within the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Deferred-Coupon Bonds

Deferred-coupon bonds are long-term securities that let the issuer avoid using cash to make interest payments for a specified number of years. There are three types of deferred-coupon structures: (1) deferred-interest bonds, (2) step-up bonds, and (3) pay-in-kind bonds. Deferred-interest bonds are those deferred-coupon structures that sell at a deep-discount and do not pay interest for the initial period. Step-up bonds do pay coupon interest, but the coupon rate is low for the initial period and then increases or "steps-up" to a higher coupon rate. Payment in-kind bonds give the issuer an option to give the bondholder a similar bond, i.e., a bond with the same coupon rate and a par value equal to the amount of the coupon payment that would have been paid.

Classification

Deferred-coupon bonds owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Deferred Drawdown Options (World Bank)

The Development Policy Loan Deferred Drawdown Option (DPL DDO) provides the borrower with the flexibility to rapidly fund its financing requirements following a shortfall in resources due to adverse economic events such as downturns in economic growth or unfavorable changes in commodity prices or terms of trade. The Catastrophe Risk DDO (Cat DDO) enables the borrower to access an immediate source of funding to respond rapidly in the aftermath of a natural disaster.

Classification

When funds are actually borrowed/lent, these loans extended by nonresidents to residents are to be included in the gross external debt position as *loans* (*other investment* in the IIP).

Depository Receipts

A depository receipt allows a nonresident entity to introduce its equity or debt into another market in a form more readily acceptable to the investors in that market. A depository bank will purchase the underlying foreign security and then issue receipts in a currency more acceptable to the investor. The investor can exchange the depository receipts for the underlying security at any time. See also *American Depository Receipts* and *Bearer Depository Receipts*.

Classification

A depository receipt is classified according to the nature of the underlying instrument backing it. This is because the "issuing" intermediary does not take the underlying security onto its balance sheet but simply acts as a facilitator. So, the debtor is the issuer of the underlying security. If owned by nonresidents, these instruments, if a debt security is the underlying instrument, are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). If the underlying item is an equity investment, it should be classified in the memorandum table, *equity liability position with nonresidents by sector* (Table 4.5) under the appropriate institutional sector. If the nonresident is in a direct investment relationship with the issuer, then the equity is classified as *direct investment: equity and investment fund shares* in the memorandum table.

Deposits

Deposits include all claims that are on the central bank, deposit-taking corporations, except the central bank, and, in some cases, other institutional units, and are represented by evidence of deposit. Deposits are claims that are either transferable or are "other deposits." Transferable deposits consist of all deposits that are exchangeable on demand at par without restriction, or penalty, and directly usable for making payments by check, giro order, direct debit/credit, or other payment facility. "Other deposits" comprise all claims, other than transferable deposits, represented by evidence of deposit, e.g., savings and fixed-term deposits; sight deposits that permit immediate cash withdrawals but not direct third-party transfers; and shares that are legally (or practically) redeemable on demand or on short notice in savings and loan associations, credit unions, building societies, etc. Liabilities under securities repurchase agreements that are included in national measures of broad money are also other deposits (while liabilities under other repurchase agreements are included in loans; see *BPM6*, paragraph 5.43).

Classification

Deposits are liabilities of central banks, deposit-taking corporations, except the central bank, and, in some cases, other institutional units, and if owned by a nonresident are to be included in the gross external debt position. They should be classified as *short-term, currency and deposits* (*other investment, currency and deposits* in the IIP), under the corresponding institutional sector, unless detailed information is available to make the short-term/long-term attribution.

In some cases, the instrument classification of interbank positions may be unclear, e.g., because the parties are uncertain or one party considers it as a loan and the other a deposit. Therefore, as a convention to ensure symmetry, all interbank positions other than debt securities and accounts receivable/payable are classified in the gross external debt position as *short-term, deposits* (*other investment, currency and deposits* in the IIP), unless detailed information is available to make the short-term/long-term attribution.

Deposits in Mutual Associations

Deposits in the form of shares or similar evidence of deposit issued by mutual associations such as savings and loans, building societies, credit unions, and the like are classified as deposits. See *Deposits*.

Classification

Deposits in mutual associations owned by nonresidents are to be included in the gross external debt position. They should be classified as deposit-taking corporations, except the central bank, *short-term, currency and deposits* (*other investment* in the IIP).

Disbursement-Linked Repayment Loans

The disbursement linked repayment loans are loans that have a repayment schedule that is linked to each disbursement and will include a grace period for the repayment of principal. The grace period, which is fixed in the loan agreement, will apply from the beginning of each actual disbursement grouping. Usually disbursement-linked repayment loans are multi-tranche loans with each tranche having a different maturity period.

Classification

Loans extended by nonresidents to residents are to be included in the gross external debt position as *loans* (*other investment* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these loans could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Dual-Currency Bonds

Dual-currency bonds are a group of debt securities where the interest and/or principal payments differ from the currency in which the bond is issued. The issue of currency-linked bonds followed the development of the currency swap market that broadened the range of currencies in which international bonds were issued.

Classification

Dual-currency bonds owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

E

Embedded Derivatives

An embedded derivative arises when a derivative feature is inserted in a standard financial instrument and is inseparable from the instrument. If a primary instrument, such as a security or loan, contains an embedded derivative, the instrument is valued and classified according to its primary characteristics—even though the value of that security or loan may well differ from the values of comparable securities and loans because of the embedded derivative. Examples are bonds that are convertible into shares, and securities with options for repayment of principal in currencies that differ from those in which the securities were issued.

Classification

Debt instruments with embedded derivatives owned by nonresidents are to be included in the gross external debt position, and they should be classified as *debt securities* or *loans* according to their primary characteristics (*portfolio investment, debt securities, or other investment, loans* in the IIP). Alternatively, depending on the relationship between debtor and creditor, the debt could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Employee Stock Options (ESOs)

Employee stock options (ESOs) are options to buy the equity of a company, offered to employees of the company as a form of remuneration. In a few cases, the company that issues the option is a resident of a different economy from the employee. ESOs have similar pricing behavior to financial derivatives, but they have a different nature and purpose (i.e., to motivate employees to contribute to increasing the value of the company, rather than to trade risk). If a stock option granted to employees can be traded on financial markets without restriction, it is classified as a financial derivative. *BPM6* includes financial derivative instruments and ESOs in the same functional category.

Classification

ESOs in which the counter-party is a nonresident are not debt instruments, and are included in Table 4.4 (memorandum table on financial derivatives and employee stock options positions with nonresidents by sector).

Equity

Equity consists of all instruments and records acknowledging, after the claims of all creditors have been met, claims to the residual values of a corporation or quasi-corporation. Equity may be split into listed shares, unlisted shares, and other equity. Both listed and unlisted shares are equity securities. Other equity is equity that is not in the form of securities. It includes equity in quasi-corporations for branches and notional units for ownership of land (in most cases), and the ownership of many international organizations. Equity is not a debt instrument, as it gives a residual claim on the assets of the entity.

Classification

Equity securities are included in the memorandum table, *equity liability position with nonresidents by sector* (Table 4.5) under the appropriate institutional sector, as well as other equity that is not direct invest-

ment. If the nonresident is in a direct investment relationship with the issuer, then the equity is classified as *direct investment: equity and investment fund shares* in the memorandum table.

Equity-Linked Bond

An equity-linked bond comprises features of both debt and equity. Equity-linked bonds are debt instruments that contain an option to purchase (either by conversion of existing debt or by exercising the right to purchase) an equity stake in the issuer, its parent, or another company at a fixed price. These instruments are usually issued when stock market prices are rising because companies can raise funds at lower than market interest rates while investors receive interest payments, and potentially lock into capital gains.

Classification

Equity-linked bonds, if owned by nonresidents, are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). If the bonds are converted into equity, the debt is extinguished. The equity issued is recorded in the memorandum table, *equity liability position with nonresidents by sector* (Table 4.5) under the appropriate institutional sector. If the nonresident is in a direct investment relationship with the issuer, then the equity is classified as *direct investment: equity and investment fund shares* in the memorandum table. See also *Equity Warrant Bond* and *Warrants*.

Equity-Linked Derivatives

Derivatives whose value derives from equity prices. These include:

Equity future—traded on an organized exchange, in which counterparties commit to buy or sell a specified amount of an individual equity or a basket of equities or an equity index at an agreed contract price on a specified date

Equity option—gives the purchaser the right but not the obligation to purchase (call) or sell (put) a specified amount of an individual equity or a basket of equities or an equity index at an agreed contract price on or before a specified date

Equity swap—in which one party exchanges a rate of return linked to an equity investment for the rate of return on another equity investment

Net cash settlements are usually made.

Classification

Equity-linked derivatives in which the counterparty is a nonresident are included indistinguishably in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Equity Warrant Bond (Debt-with-Equity Warrants)

Equity warrant bonds are debt securities that incorporate warrants, which give the holder the option to purchase equity in the issuer, its parent company, or another company during a predetermined period or on one particular date at a fixed contract price. The warrants are detachable and may be traded separately from the debt security. The exercise of the equity warrant will normally increase the total capital funds of the issuer because the debt is not replaced by equity but remains outstanding until the date of its redemption. The issue of equity warrant bonds reduces the funding costs for borrowers because the investor will generally accept a lower yield in anticipation of the future profit to be gained from exercising the warrant.

Classification

Because the warrant is detachable and may be traded separately from the debt security, the two instruments should be separately recorded. Bonds owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). Warrants owned by nonresidents are to be included indistinguishably in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Exchange Traded Funds

An exchange-traded fund (ETF) is a fund—similar to a mutual fund—with a fixed share capital, where investors entering or leaving the fund must buy or sell existing shares. An ETF tracks indices, such as for stocks, commodities, or bonds and is traded over the course of the trading day on an exchange.

Classification

Exchange traded funds shares owned by nonresidents are equity investments to be included in the memorandum table, *equity liability position with nonresidents by sector* (*Table 4.5*).

F

Financial Lease

A financial lease is a contract under which a lessor as legal owner of an asset conveys substantially all the risks and rewards of ownership of the asset to the lessee. While there is not a legal change of ownership of the good under the financial lease, the risks and rewards are, de facto, transferred from the legal owner of the good, the lessor, to the user of the good, the lessee. For this reason, under statistical convention, the total value of the good is imputed to have changed economic ownership. Therefore, the debt liability at inception of the lease is defined as the value of the good and is financed by a loan of the same value, a liability of the lessee (see paragraph 3.39).

Classification

Debt liabilities arising from financial leases between residents and nonresidents are to be included in the gross external debt position as loans (*other investment* in the lIP). Alternatively, depending on the relationship between debtor and creditor, the debt could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Fixed-Rate Bond

A bond whose coupon payments are set for the life of the bond or for a certain number of years. See also *Variable-Rate Bond*.

Classification

Fixed-rate bonds owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Foreign Bonds

A foreign bond is a security issued by a nonresident borrower in a domestic capital market, other than its own, usually denominated in the currency of that market. Issues are placed publicly or privately. These bonds generally adopt the characteristics of the domestic market of the country in which they are issued, such as in terms of registration—bearer or registered form—settlement, and coupon payment arrangements. Common foreign bonds are Yankee bonds (U.S. market), Samurai bonds (Japan), and Bulldog bonds (U.K.).

Classification

If the owner of the foreign bond is a nonresident, and this is most likely given that the bonds are issued in foreign markets, the bonds are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Foreign-Currency-Linked Derivatives

Derivatives whose value is linked to foreign currency exchange rates. The most common foreign-currency-linked derivatives are:

- Forward-type foreign exchange rate contracts, under which currencies are sold or purchased for an agreed exchange rate on a specified day
- Foreign exchange swaps, whereby there is an initial exchange of foreign currencies and a simultaneous forward purchase/sale of the same currencies
- Cross-currency interest rate swaps, whereby—following an initial exchange of a specified amount of foreign currencies—cash flows related to interest and principal payments are exchanged according to a predetermined schedule

- Options that give the purchaser the right but not the obligation to purchase or sell a specified amount of a foreign currency at an agreed contract price on or before a specified date

Classification
Foreign-currency-linked derivatives in which the counterparty is a nonresident are included indistinguishably in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Forward-Type Derivatives

A contract in which two counterparties commit to exchange an underlying item—real or financial—in a specified quantity, on a specified date, at an agreed contract price or, in the specific example of a swaps contract, agree to exchange cash flows, determined by reference to the price(s) of, say, currencies or interest rates according to predetermined rules. In essence, two counterparties are trading risk exposures of equal market value.

Classification
Forward-type derivatives in which the counterparty is a nonresident are included in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Futures

Futures are forward-type contracts traded on organized exchanges. The exchange facilitates trading by determining the standardized terms and conditions of the contract, acting as the counterparty to all trades, and requiring margin to be deposited and paid to mitigate against risk. See also *Forward-Type Derivatives*.

Classification
Futures in which the counterparty is a nonresident are included in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

G

Gold Accounts: Allocated and Unallocated

Allocated gold accounts provide ownership of a specific piece of gold. The ownership of the gold remains with the entity placing it for safe custody. Allocated gold accounts have no counterpart liability. When held as reserve assets, allocated gold accounts are classified as monetary gold. When not held as reserve assets, allocated gold accounts are treated as representing ownership of a good. In contrast, unallocated gold accounts represent a claim against the account operator to deliver gold. For these accounts, the account provider holds title to a reserve base of physical (allocated) gold and issues claims to account holders denominated in gold. Unallocated gold account liabilities are debt liabilities of the account operator.

Classification
All unallocated gold accounts liabilities are treated as deposits. If owned by nonresidents, unallocated gold accounts are to be included in the gross external debt position, and they should be classified as *short-term, currency and deposits* (*other investment, currency and deposits* in the IIP).

Gold Loans

Gold loans consist of the delivery of gold for a given time period. They may be associated with physical gold or (less frequently) unallocated gold accounts. As with securities lending, legal ownership of the gold is transferred (the temporary borrower may on-sell the gold to a third party), but the risks and benefits of changes in the gold price remain with the lender, that is the gold is assumed not to have changed ownership and remains on the balance sheet of the gold provider. No cash is provided as collateral in gold loan transactions.

Classification
No debt position is created for gold loans, as no cash is provided.

Gold Swaps

A gold swap involves an exchange of gold for foreign exchange deposits with an agreement that the transaction be reversed at an agreed future date at an agreed gold price. The gold taker (cash provider) will not usually record the gold on its balance sheet, while the gold provider (cash taker) will not usually remove the gold from its balance sheet. In this manner, the transaction is analogous to a repurchase agreement and should be recorded as a collateralized loan or deposit. See Appendix 2; see also *Repurchase Agreements* in Part 2 of this appendix.

Classification
For the cash taker, a gold swap is classified as a loan or a deposit; so borrowing under a gold swap from a nonresident is included within the gross external debt position. A gold swap is generally a loan, but it is clas-

sified as a deposit if it involves liabilities of a deposit-taking corporation that are included in national measures of broad money. The debt should be classified as *loans* or as *currency and deposits* (*other investment* in the IIP).

I

Index-Linked Securities

Index-linked securities are debt instruments with coupon and/or principal payments linked to commodity prices, interest rates, stock exchange, or other price indices. The benefits to the issuer of indexing include a reduction in interest costs if the deal is targeted at a particular group of investors' requirements, and/or an ability to hedge an exposed position in a particular market. The benefit to investors is in the ability to gain exposure to a wide range of markets (e.g., foreign exchange or property markets) without the same degree of risk that may be involved in investing in the markets directly. Issues linked to a consumer price index also provide investors with protection against inflation.

Classification

Index-linked securities owned by nonresidents are to be included within the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). When interest payments are index linked, the payments are treated as interest. If the value of the principal is index linked, the issue price should be recorded as principal, and any subsequent change in value due to indexation changes the value of the principal amount (see also *BPM6,* paragraphs 11.6–11.65).

Insurance, Pension, and Standardized Guarantee Schemes

Insurance, pension, and standardized guarantee schemes is a type of debt instrument that comprises (1) nonlife insurance technical reserves; (2) life insurance and annuity entitlements; (3) pension entitlements, claims of pension funds on pension managers, and entitlements to nonpension funds; and (4) provisions for calls under standardized guarantees (these items are separately described in this Appendix).

Classification

Insurance, pension, and standardized guarantee schemes that are liabilities to nonresidents policyholders or beneficiaries are to be included in the gross external debt position as *other debt liabilities* (*other investment, insurance, pension, and standardized guarantee schemes* in the IIP). Alternatively, depending on the relationship between debtor and creditor, the debt could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Interest-Rate-Linked Derivatives

Derivatives whose value is linked to interest rates. The most common are:

- Interest rate swaps, which involve an exchange of cash flows related to interest payments, or receipts, on a notional amount of principal in one currency over a period of time
- Forward rate agreements, in which a cash settlement is made by one party to another calculated by the difference between a market interest rate of a specified maturity in one currency on a specific date and an agreed interest rate, times a notional amount of principal that is never exchanged (if the market rate is above the agreed rate, one party will agree to make a cash settlement to the other, and vice versa)
- Interest rate options that give the purchaser the right to buy or sell a specified notional value at a specified interest rate—the price traded is 100 less the agreed interest rate in percentage terms, with settlement based on the difference between the market rate and the specified rate times the notional value.

Classification

Interest-rate-linked derivatives in which the counterparty is a nonresident are included indistinguishably in the memorandum table, *financial derivatives and employee stock options positions with nonresidents by sector* (Table 4.4).

Investment Fund Shares or Units

Investment funds are collective investment undertakings through which investors pool funds for investment in financial or nonfinancial assets or both. These

are sometimes known as mutual funds. These funds issue shares (if a corporate structure is used) or units (if a trust structure is used). The shares in the fund purchased by individual investors represent an ownership interest in the pool of underlying assets—i.e., the investors have an equity stake. Because professional fund managers make the selection of assets, investment funds provide individual investors with an opportunity to invest in a diversified and professionally managed portfolio of securities without the need of detailed knowledge of the individual companies issuing the stocks and bonds. Investment funds include money market funds (MMF) and non-MMF investment funds. MMFs are investment funds that invest only or primarily in short-term debt securities such as treasury bills, certificates of deposit, and commercial paper. Non-MMF investment funds mainly invest in a range of assets, long-term in nature, also including commodity-linked investments, real estate, shares in other investment funds, and structured assets.

Classification

Investment fund shares or units owned by nonresidents are equity investments to be included in the memorandum table, *equity liability position with nonresidents by sector* (Table 4.5).

L

Land and Other Natural Resources Ownership

By convention, land and other natural resources such as subsoil assets, noncultivated biological resources, and water can only be owned by residents. Therefore, if a nonresident purchases these assets, then a notional resident entity is created on which the nonresident has a financial claim (unless the land or other natural resources are a territorial enclave of the nonresident—see *BPM6* paragraph 4.5(e)). Also, if a nonresident leases these assets for long periods, then it is usually the case that a branch should be recognized (see *BPM6* paragraph 4.35).

Classification

The financial claim the nonresident has on the notional resident entity is assumed to be a direct investment equity investment, so the equity investment is classified in the memorandum table, *equity liability position with nonresidents by sector (Table 4.5) under direct investment: equity and investment fund shares.*

Letters of Credit

Letters of credit provide a guarantee that funds will be made available only when certain documents specified by contract are presented, but no financial liability exists until funds are actually advanced.

Classification

Because letters of credit are not debt instruments, they are not included within the gross external debt position.

LIBOR-Based Loans (LBL)

These are loans commonly offered by multilateral institutions to both sovereign and nonsovereign borrowers. The terms of borrowing are based on a LIBOR rate, an effective contractual spread and, where applicable, a maturity premium fixed over the life of the loan. The loans are extended in the various currencies offered by the multilateral institution. These loans normally provide a high degree of flexibility for borrowers like: (1) choice of interest rate basis; (2) embedded options (i.e., currency and interest rate swaps); and (3) choice of currency.

Classification

LIBOR-based loan extended by nonresidents to residents are to be included in the gross external debt position as *loans* (*other investment* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Life Insurance and Annuity Entitlements

This instrument consists of reserves of life insurance companies and annuity providers for prepaid premiums and accrued liabilities to life insurance policyholders and beneficiaries of annuities. Life insurance and annuity entitlements are used to provide benefits to policyholders upon the expiry of the policy, or to compensate beneficiaries upon the death of policyholders, and thus are kept separate from shareholders' funds. These entitlements are regarded as liabilities of the insurance companies and assets of the policyholders and beneficiaries. See also *Insurance, Pension, and Standardized Guarantee Schemes*.

Classification

Life insurance and annuity entitlements that are liabilities to nonresident policyholders or beneficiaries

are to be included in the gross external debt position as *other debt liabilities* (*other investment, insurance, pension, and standardized guarantee schemes* in the IIP). Alternatively, depending on the relationship between debtor and creditor, the debt could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Loans

Loans comprise those financial assets created through the direct lending of funds by a creditor to a debtor through an arrangement in which the lender either receives no security evidencing the transaction or receives a nonnegotiable document or instrument. Included are loans to finance trade, other loans and advances (including mortgages), use of IMF credit, and loans from the IMF. In addition, finance leases and repurchase agreements are covered under loans. The supply and receipt of funds under a securities repurchase agreement is generally treated as a loan, unless the securities repurchase agreement involves liabilities of a deposit-taking corporation that are included in national measures of broad money when it is classified as a deposit. An overdraft arising from the overdraft facility of a transferable deposit account is classified as a loan. However, undrawn lines of credit are not recognized as a liability. Loans may be payable in the domestic or foreign currency(s).

Classification

Loans extended by nonresidents to residents are to be included in the gross external debt position as *loans* (*other investment* in the IIP). Alternatively, depending on the relationship between debtor and creditor, the debt could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

M

Margins

Margins are payments of cash or deposits of collateral that cover actual or potential obligations incurred in financial derivative and some other contracts. The mandatory provision of margin is standard in financial derivative markets and reflects market concerns over counterparty risks. Repayable margins consist of cash or other collateral deposited to protect the counter party against default risk. Ownership of the margin remains with the unit that deposited it. Repayable margins in cash are a debt liability of the taker of the margin. Non-repayable margin payments reduce the liability created through a financial derivative. The entity that pays nonrepayable margin no longer retains the ownership of the margin nor has the right to the risks and rewards of ownership.

Classification

The classification of margins depends on whether they are repayable or nonrepayable. Repayable margins in cash in which the counterparty is a nonresident are to be included in the gross external debt position. They should be classified as *short-term, currency and deposits* (particularly, if the debtor's liabilities are included in broad money) or in *short-term, other debt liabilities* (*other accounts receivable/payable-other* in the IIP). Nevertheless, when a repayable margin deposit is made in a noncash asset (such as securities), no position is recorded because no change in economic ownership has occurred.

Medium-Term Notes (MTNs)

These are debt instruments of usually one- to five-year maturity issued in bearer form under a program agreement through one or more dealers. Once a program is set up, issues can be made quickly to take advantage of market conditions, with issues structured more closely to investors' needs than in the public bond markets. Typically, the MTN market is not as liquid as the international bond market, so issuers may have to pay a higher interest rate.

Classification

Medium-term notes owned by nonresidents are to be included within the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Military Debt

Loans and other credits extended for military purposes.

Classification
Military debt owed to nonresidents is to be included in the gross external debt position, allocated by the nature of the debt instrument.

Mortgage-Backed Securities

A mortgage-backed security is a form of asset-backed security. See *Asset-Backed Securities*. These securities are also referred to as collateralized mortgage obligations. The various tranches of these instruments—first tranche repaid first, the second tranche next, etc.—attract investors with differing sensitivities to prepayment risk.

Classification
Mortgage-backed securities owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP).

Multi-Currency Loans—Pooled and Nonpooled

A multi-currency loan—pooled—is a loan facility than can be disbursed in more than one currency and repaid in any other applicable currency. A multi-currency loan—nonpooled—is a loan facility than can be disbursed in more than one currency and repaid in the currencies that were disbursed. The currencies in which the loan can be disbursed or repaid should be those currencies that are applicable to the creditor.

Classification
Multi-currency loans—pooled and nonpooled—extended by nonresidents to residents are to be included in the gross external debt position as *loans* (*other investment* in the IIP). Alternatively, depending on the relationship between debtor and creditor, the debt could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Mutual Fund Shares

See *Investment Fund Shares or Units*.

N

Nondeliverable Forward Contracts (NDFs)

A nondeliverable forward contract is a foreign currency financial derivative instrument. An NDF differs from a normal foreign currency forward contract in that there is no physical settlement of two currencies at maturity. Rather, based on the movement of two currencies, a net cash settlement will be made by one party to the other. NDFs are commonly used to hedge local currency risks in emerging markets where local currencies are not freely convertible, where capital markets are small and undeveloped, and where there are restrictions on capital movements. Under these conditions, an NDF market might develop in an offshore financial center, with contracts settled in major foreign currencies, such as the U.S. dollar.

Classification
NDF contracts in which the counterparty is a nonresident are included indistinguishably in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Nonlife Insurance Technical Reserves

Non-life insurance technical reserves consist of reserves for unearned insurance premiums, which are prepayment of premiums, and reserves against outstanding insurance claims, which are amounts identified by insurance corporations to cover what they expect to pay out arising from events that have occurred but for which the claims are not yet settled. Both nonlife direct insurance and reinsurance are included in this item. These reserves represent liabilities of the insurer and a corresponding asset of the policyholders. See also *Insurance, Pension, and Standardized Guarantee Schemes*.

Classification
Non-life insurance technical reserves that are liabilities to nonresidents policyholders are to be included in the gross external debt position as *other debt liabilities* (*other investment, insurance, pension, and standardized guarantee schemes* in the IIP). Alternatively, depending on the relationship between debtor and creditor, the debt could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Nonnegotiable Debt

Debt instruments that are not usually negotiable in organized and other financial markets.

Classification
Nonnegotiable debt owned by nonresidents is to be included in the gross external debt position. The

financial instrument classification will depend on the nature of the instrument.

Nonparticipating Preferred Shares

These are a type of preferred shares in which the payment of a "dividend" (usually at a fixed rate) is calculated according to a predetermined formula and not determined by the earnings of the issuer. In other words, the investor does not participate in the distribution of profits to equity investors (if any), nor share in any surplus on dissolution of the issuer. See also *Preferred Shares* and *Participating Preferred Shares*.

Classification

Non-participating preferred shares are debt instruments, and so if owned by a nonresident are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Note Issuance Facilities (NIFs)/Revolving Underwriting Facilities (RUFs)

A note issued under an NIF/RUF is a short-term instrument issued under a legally binding medium-term facility—a form of revolving credit. A bank, or banks, underwrite, for a fee, the issuance of this three- or six-month paper and may be called upon to purchase any unsold paper at each rollover date, or to provide standby credit facilities. The basic difference between an NIF and an RUF is in the underwriting guarantee: under an RUF the underwriting banks agree to provide loans should the issue fail, but under an NIF they could either lend or purchase the outstanding notes. First developed in the early 1980s, the market for NIFs grew substantially for a short period in the mid-1980s. It was a potentially profitable market for international banks at a time when the syndicated credits market was depressed, following the debt crisis of the early 1980s. By the early 1990s, euro commercial paper (ECP), and euro medium-term notes (EMTNs) had become more popular forms of finance.

Classification

Notes issued under an NIF/RUF that are owned by a nonresident are to be included in the gross external debt position. They should be classified as *short-term, debt securities* (*portfolio investment, debt securities* in the IIP). This is because the contractual maturity is less than one year's maturity. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

O

Operational Leases

Operational leases are arrangements in which machinery or equipment is rented out for specified periods of time that are shorter than the total expected service lives of the machinery or equipment. Typically under an operational lease, the lessor normally maintains the stock of equipment in good working order, and the equipment can be hired on demand or at short notice; the equipment may be rented out for varying periods of time; and the lessor is frequently responsible for the maintenance and repair of the equipment as part of the service which he provides to the lessee. Under an operational lease, ownership of the equipment does not change hands; rather, the lessor is regarded as providing a service to the lessee, on a continuous basis.

Classification

Operational leases are not financial instruments, but rather the provision of a service, the cost of which accrues continuously. Any payments under an operational lease are either classified as prepayments for services—creating a trade credit and advances claim on the lessor—or postpayments for services rendered—extinguishing a trade credit and advances liability to the lessor.

Options

An option is a contract that gives the purchaser the right but not the obligation to buy (call) or sell (put) a specified underlying item—real or financial—at an agreed contract (strike) price on or before a specified date from the writer of the option.

Classification

Options owned by nonresidents are to be included in Table 4.4 (memorandum table on *financial derivatives*

and employee stock options positions with nonresidents by sector).

Original Issue Discount Bond

An original issue discount (OID) bond is issued at a price below par. A zero-coupon bond is an example of an OID bond. See also *Deep Discount Bond* and *Zero-Coupon Bonds*.

Classification

OID bonds owned by nonresidents are to be included within the gross external debt position. They should be classified as *long-term, debt securities (portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as short-term, debt securities. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Other Accounts Receivable/Payable-Other

Other accounts receivable/payable-other include arrears arising from nondebt instruments and transactions (see Chapter 3, paragraph 3.43), and liabilities such as in respect of taxes, dividends, purchases and sales of securities, security lending fees, wages and salaries and social contributions that have accrued but are not yet paid.

Classification

Other accounts payable-other owed to nonresidents are to be included in the gross external debt position. They should be classified as *other debt liabilities* (*other investment, other accounts receivable/payable-other* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

P

Participating Preferred Shares

Also known as a participating preference share. These are a type of preferred share where the investor has some entitlement to a share in the profits or a share of any surplus on dissolution of the issuer (in addition to the fixed dividend payment received). See also *Preferred Shares* and *Nonparticipating Preferred Shares*.

Classification

Because of the claim on the residual value of the issuer, participating preference shares are classified as equity instruments, and so are included in the memorandum table, *equity liability position with nonresidents by sector* (Table 4.5) under the appropriate institutional sector. If the nonresident is in a direct investment relationship with the issuer, then the equity is classified as *direct investment: equity and investment fund shares* in the memorandum table.

Pension Entitlements

Pension entitlements show the extent of financial claims both existing and future pensioners hold against either their employer or a fund designated by the employer to pay pensions earned as part of a compensation agreement between the employer and employee. The economy of residence of pension schemes may differ from that of some of their beneficiaries, in particular, for border workers, guest workers who return home, people who retire to a different economy, staff of international organizations, and employees of transnational enterprise groups that have a single pension fund for the whole group. In addition to liabilities of pension funds, liabilities of unfunded pension schemes are included in this category. These entitlements represent liabilities of the pension fund and a corresponding asset of the beneficiaries. See also *Insurance, Pension, and Standardized Guarantee Schemes*.

Classification

Pension entitlements that are liabilities to nonresidents policyholders or beneficiaries, are to be included in the gross external debt position as *other debt liabilities* (*other investment, insurance, pension, and standardized guarantee schemes* in the IIP).

Permanent Interest-Bearing Shares (PIBS)

These are deferred shares issued by mutual societies, which rank beneath ordinary shares (which are more akin to deposits than equity in mutual societies) and all other liabilities (including subordinated debt) in the event of dissolution of the society. They provide “permanent” capital. In the United Kingdom these instruments are non-profit-participating by regulatory requirement; rather, predetermined (but not necessarily fixed) interest costs are payable, with the amounts to be paid not linked to the issuer’s profits; interest costs are not to be paid if this would result in

the society breaching capital adequacy guidelines and are noncumulative; but more PIBS can be issued in lieu of a cash dividend.

Classification

PIBS are debt instruments because they are a form of nonparticipating preferred share (defined as such because the holders of the instruments do not participate in the profits of the society). PIBS owned by nonresidents are to be included within the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Perpetual Bonds

Perpetual bonds are debt instruments with no maturity date although interest is paid.

Classification

Perpetual bonds should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Perpetual Floating-Rate Notes

A debt security whose coupon is refixed periodically on a refix date by reference to an independent interest rate index such as three-month LIBOR. Generally, these instruments are issued by financial institutions, particularly banks, and are perpetual so as to replicate equity and qualify as tier-one capital under the Basel capital adequacy requirements (subject to the security meeting a range of additional regulatory requirements, such as giving the issuer flexibility to cancel coupon payments).

Classification

Despite the perpetual nature of these instruments, they are debt securities because the instruments give the holder a contractually determined money income. Perpetual floating-rate notes owned by nonresidents are to be included within the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Precious Metals (Other than Gold) Accounts: Allocated and Unallocated

Allocated precious metals accounts provide ownership of a specific piece of precious metals. The ownership of the precious metal remains with the entity placing it for safe custody. Allocated precious metals accounts have no counterpart liability. Allocated precious metals (other than gold) accounts are treated as representing ownership of a good, they are not financial assets. In contrast, unallocated precious metals accounts represent a claim against the account operator to deliver precious metals. For these accounts, the account provider holds title to a reserve base of physical (allocated) precious metals and issues claims to account holders denominated in precious metals. Unallocated precious metals account liabilities are debt liabilities of the account operator (see also *Gold Accounts: Allocated and Unallocated*).

Classification

All unallocated precious metals accounts liabilities are treated as deposits. If owned by nonresidents, unallocated precious metals accounts are to be included in the gross external debt position, and they should be classified as short-term, currency and deposits (other investment, currency and deposits in the IIP).

Preferred Shares

Also known as a preference share. Preferred shares are a class of equity capital that rank ahead of common equity in respect of dividends and distribution of assets upon dissolution of the incorporated enterprise. Investors have little control over the decisions of the company: voting rights are normally restricted to situations where the rights attached to preferred shares are being considered for amendment. Preferred shares are registered securities. Preferred share issues typically pay a fixed-rate dividend payment that is calculated according to a predetermined formula, but some preferred shares participate in the profits of the issuer.

Classification

Preferred shares are classified as equity securities if the shares are participating and debt securities if the shares are nonparticipating. See *Nonparticipating*

and *Participating Preferred Shares* for specific classification requirements.

Project Preparation Facility

A loan facility that is provided to support project preparation. The outcome of the preparation will determine whether the facility will be treated as standalone loan, or will form part of the facility to be extended to the borrower for the purposes of implementing the project.

Classification

Loans extended by nonresidents to residents to support project preparation are to be included in the gross external debt position as *loans* (*other investment* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these loans could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Promissory Note

An unconditional promise to pay a certain sum on demand on a specified due date. Promissory notes are widely used in international trade as a secure means of payment. They are drawn up (issued) by an importer in favor of the exporter. When the latter endorses the note, provided the importer is creditworthy, a promissory note is traded.

Classification

Promissory notes are debt securities that are claims on the issuer. If owned by nonresidents, promissory notes should be included in the gross external debt position. They should be classified as *short-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity over one year, in which instance they are to be classified as *long-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Provisions for Calls Under Standardized Guarantees

Standardized guarantees are defined as those that are not provided by means of a financial derivative (such as credit default swaps), but for which the probability of default can be well established. These guarantees cover similar types of credit risk for a large number of cases. Examples include guarantees issued by governments on export credit or student loans. Generally it is not possible to estimate precisely the risk of any one loan being in default, but it is possible to make a reliable estimate of how many out of a large number of such outstanding loans will default. These provisions represent liabilities of the issuer of standardized guarantees, and a corresponding asset of the beneficiaries. See also *Insurance, Pension, and Standardized Guarantee Schemes.*

Classification

Provisions for calls under standardized guarantees that are liabilities to nonresidents policyholders or beneficiaries are to be included in the gross external debt position as *other debt liabilities* (*other investment, insurance, pension, and standardized guarantee schemes* in the IIP).

Putable Bonds

A putable bond is a bond in which the bondholder has the right to sell the bond to the issuer at a designated price and time before the expiration date of the security.

Classification

Putable bonds owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

R

Recognition Bonds

Recognition bonds are bonds issued by a government in some economies to recognize accrued social security contributions made by public workers joining a new scheme.

Classification

Recognition bonds owned by nonresidents are to be included in the gross external debt position. Debt securities should be classified as *long-term, debt securities*, if issued with an original maturity of over one year, or as *short-term, debt securities*, if issued with an original maturity or one year or less (*portfolio investment, debt securities* in the IIP).

Reverse Security Transactions

See Appendix 2.

S

Single Currency Loans

Loans which allow the borrower to make drawings and repayments in the same currency only.

Classification

Single currency loans extended by nonresidents to residents are to be included in the gross external debt position as *loans* (*other investment* in the IIP). Alternatively, depending on the relationship between debtor and creditor, the debt could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Special Drawing Rights

Special drawing rights (SDRs) are international reserve assets created by the IMF and allocated to members to supplement existing official reserves. SDRs are held only by the depositories of IMF members, a limited number of international financial institutions that are authorized holders, and the IMF itself, through the General Resources Account. SDR holdings (assets) represent unconditional rights to obtain foreign exchange or other reserve assets from other IMF members. SDRs allocated by the Fund to a member that is a participant in the SDR Department are a long-term liability of the member because upon termination of participation in, or liquidation of, the SDR Department, the member will be required to repay these allocations, and also because interest accrues. The holdings and allocations should be shown gross, rather than netted.

Classification

SDR allocations are to be included in the gross external debt position, classified as *long-term, special drawing rights* (*allocations*) (*other investment, special drawing rights* in the IIP).

Stripped Securities

Stripped securities are securities that have been transformed from a principal amount with periodic interest coupons into a series of zero-coupon bonds, with the range of maturities matching the coupon payment dates and the redemption date of the principal amount. Strips can be created in two ways. Either the owner of the original security can ask the settlement or clearing house in which the security is registered to "create" strips from the original security, in which case the strips replace the original security and remain the direct obligation of the issuer of the security; or the owner (a third party) of the original security can issue strips in its own name, "backed" by the original security, in which case the strips represent new liabilities and are not the direct obligation of the issuer of the original security. Usually, short-term strips are bought by money managers as government bill or note substitutes; intermediate maturity strips will be purchased by investors who believe that the yield curve might become more positive. Whereas demand is strongest for the longer maturities because these instruments have longer duration than the original bonds and are leveraged investments, a relatively small up-front payment gives the investor exposure to a larger nominal amount.

Classification

Stripped securities owned by a nonresident are to be included in the gross external debt position. Depending on their maturity, a stripped security is to be classified as either *short-term, debt securities* (original maturity of one year or less) or *long-term, debt securities* (original maturity of over one year) (*portfolio investment, debt securities* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). The residence of the issuer depends on who has issued the strips. If the owner of the original security issues the stripped bonds, then the residence of the issuer is that of the entity issuing the strips; the underlying securities remain extant. If the strips remain the direct obligation of the original issuer, then the issuer is the original issuer, and the strips "replace" the original securities that have been stripped.

Structured Bonds

Structured bonds have characteristics that are designed to attract a certain type of investor and/or take advantage of particular market circumstances. However, structuring securities to appeal to a particular type of investor risks the possibility of a loss of liquidity if the market moves in such a way as to make the structured features of the issue no longer attractive. Typically, the structured features are achieved through the use of derivatives—for instance, a credit-

linked note is a bond with an embedded credit derivative, and therefore inseparable from the debt security.

Classification

Structured bonds are debt instruments, and if owned by a nonresident are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). Any embedded derivative is regarded as an integral part of the bond and not separately valued and identified.

Structured Floating-Rate Notes

The structured floating-rate note is a variation of a standard variable-rate bond (i.e., a long-dated debt security whose coupon payment is reset periodically by reference to an independent interest rate index such as six-month LIBOR). The structured issue includes a derivative that allows the coupon calculation to be tailored to meet investors' interest rate expectations. For instance, there may be an interest rate collar or band—the interest rate cannot increase above an upper specified rate or fall below a lower specified rate. The issue of structured floating-rate notes has grown as borrowers have used financial derivatives to tailor financing products to investor demands while meeting their own funding needs.

Classification

Structured floating-rate notes are debt instruments, and if owned by a nonresident are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). Any embedded derivative is regarded as an integral part of the note and not separately valued and identified.

Sukuk

Sukuk are Islamic instruments that are issued by Islamic financial institutions. A distinguishing feature of Sukuk is that they are structured to be consistent with Islamic law, which does not allow the charging of interest. The holders are entitled to a share (rent) from the return on the underlying assets. Sukuk can be classified by type of underlying contract, such as Murābahah, Ijārah, Salam, Istisnā, Mushārakah, Mudārabah, and Wakalah.

Classification

For the purpose of compiling external debt statistics, Sukuk should be classified as debt instruments, unless the owner of the security has a claim on the residual value of the issuing entity, and if owned by a nonresident are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. For further details on the classification of Sukuk by type of underlying contract, see Annex 2 in the *Handbook on Securities Statistics, Part 1: Debt Securities Issues*.

Swaps

A forward-type financial derivative contract in which two counterparties agree to exchange cash flows determined with reference to prices of, say, currencies or interest rates, according to predetermined rules. At inception, this instrument typically has zero market value, but as market prices change the swap acquires value.

Classification

Swaps in which the counterparty is a nonresident are included in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Syndicated Loans

A syndicated loan is a loan offered by two or more lending institutions on similar terms and conditions using common documentation and administered by a common agent. Also referred as a "Consortium Loan."

Classification

Syndicated loans extended by nonresidents to residents are to be included in the gross external debt position as *loans* (*other investment* in the IIP). Alter-

natively, depending on the relationship between debtor and creditor, the debt could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

T

Total Return Swap

A credit derivative that swaps the total return on a financial instrument, cash flows and capital gains and losses, for a guaranteed interest rate, such as an interbank rate, plus a margin.

Classification

Total return swaps in which the counterparty is a nonresident are included in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Trade Credit and Advances

Trade credit and advances consist of (1) credit extended directly by the suppliers of goods and services to their customers and (2) advances for work that is in progress (or is yet to be undertaken) and prepayment by customers for goods and services not yet provided (the debt is extinguished when the supplier provides the goods and/or services).

Classification

Trade credit and advances owed to nonresidents is to be included in the gross external debt position. Such credit should be classified as *trade credit and advances* (*other investment* in the IIP). Alternatively, depending on the relationship between debtor and creditor, the credit could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). For the treatment of progress payments for high-value capital goods (see Part 2 of this appendix). The *2008 SNA* and *BPM6* regard *trade credit and advances* as a form of other accounts receivable/payable (*2008 SNA,* paragraph 11.126 and *BPM6*, paragraph 5.69).

Treasury Bills

A common form of sovereign short-term debt; many governments of the world issue treasury bills. Typically issued through the central bank with maturities ranging from four weeks to two years, they are typically issued at a discount to face value and are redeemed at par.

Classification

Treasury bills are debt instruments, and so if owned by a nonresident are to be included in the gross external debt position. These bills should be classified as *short-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of more than one year, in which instance they are to be classified as *long term, debt securities*.

U

Use of IMF Credit and Loans

These comprise members' drawings on the IMF other than those drawn against the country's reserve tranche position. Low-income countries may borrow on concessional terms through the Extended Credit Facility (ECF), the Standby Credit Facility (SCF), and the Rapid Credit Facility (RCF). Non-concessional loans are provided mainly through Stand-By Arrangements (SBA), the Flexible Credit Line (FCL), the Precautionary and Liquidity Line (PLL), and the Extended Fund Facility (EFF). The IMF also provides emergency assistance via the Rapid Financing Instrument (RFI) to all its members facing urgent balance of payments needs. Detailed information on the use of IMF Credit and Loans is available at www.imf.org/external/np/exr/facts/howlend.htm.

Classification

Use of IMF credit and loans is to be included in the gross external debt position and classified as *central bank, long term, loans* (*other investment, central bank, loans* in the IIP), and/or *general government, long term, loans*, (*other investment, loans, general government* in the IIP). Because of the particular accounting procedures of the IMF, the use of IMF credit might be considered to have some of the characteristics of a swap of currencies. However, since the IMF has lent in SDR terms, with payments in SDR terms, at an interest rate that is SDR-related, the recommended classification reflects the economic nature of the transaction—a loan.

V

Variable-Rate Bond

A bond whose interest payments are linked to a reference index (e.g., LIBOR), or the price of a specific commodity, or the price of a specific financial instrument that normally changes over time in a continuous manner in response to market pressures.

Classification

Variable-rate bonds owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Variable-Rate Notes (VRNs)

These securities adopted the standard characteristics of a variable-rate bond. However, whereas a standard characteristic of a variable-rate bond is that it carries a fixed spread over a referral index, the spread over LIBOR on a VRN varies over time depending on the change in the perceived credit risk of the issuer. The spread is reset at each rollover date—normally every three months—by means of negotiation between the issuer and arranging house. VRNs are usually issued with no maturity date (perpetual VRNs) but fixed five-year and longer-dated issues are in existence. VRNs generally have a put option for the existing holders of notes to sell the issue back to the lead manager of the issuing syndicate, at par, at any interest payment date.

Classification

VRNs owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3). The put option, embedded in the instrument, is not valued and classified separately.

W

Warrants

Warrants are a form of financial derivative giving the owner the right but not the obligation to purchase or sell from the issuer of the warrant a fixed amount of an underlying asset, such as equities and bonds, at an agreed contract price for a specified period of time or on a specified date. Although similar to traded options, a distinguishing factor is that the exercise of the warrants can create new securities, thus diluting the capital of existing bond or shareholders, whereas traded options typically grant rights over assets that are already available. Warrants can be issued in their own right or with equity or bonds to make the underlying issue more attractive. They can be quoted and traded separately in the secondary market.

Classification

Warrants owned by nonresidents are to be included in Table 4.4 (memorandum table on *financial derivatives and employee stock options positions with nonresidents by sector*).

Z

Zero-Coupon Bonds

A single-payment security that does not involve interest payments during the life of the bond. The bond is sold at a discount from par value, and the full return is paid at maturity. The difference between the discounted issue price and the face or redemption value reflects the market rate of interest at the time of issue and time to maturity. The longer the maturity of the bond and the higher the interest rate, the greater the discount against the face or redemption value. Zero-coupon and deep-discount bonds have four particular characteristics for investors:

- There may be some tax advantage in receiving a capital gain rather than an income payment
- There is no or little (deep-discount bond) reinvestment risk (the possibility that when coupon payments fall due, and need to be reinvested, interest rates will be lower)
- The bond has a longer "duration" than a bond of comparable maturity that pays fixed- or variable-rate interest, so making the zero-coupon bond's price more sensitive to interest rate changes
- A zero-coupon bond is a leveraged investment in that a relatively small initial outlay gives exposure to a larger nominal amount

See also *Deep-Discount Bond.*

Classification

Zero-coupon bonds owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, debt securities* (*portfolio investment, debt securities* in the IIP) unless they have an original maturity of one year or less, in which instance they are to be classified as *short-term, debt securities*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *Direct investment: Intercompany lending* (see the description of *direct investment* in Chapter 3).

Part 2. Description and Classification of Specific Transactions

This section discusses the classification treatment within the gross external debt position of specific transactions.

B

Borrowing for Fiscal Purposes

Borrowing for fiscal purposes refers to when a special purpose entity (SPE) or other entity owned or controlled by the general government is resident in another territory and borrows for fiscal purposes. Fiscal purposes can be distinguished because, unlike commercial purposes, they are always oriented to serving the fiscal objectives of the government, e.g., a government may use an SPE or other entity to issue securities to fund its expenditures. Special rules are introduced in *BPM6* in relation to this type of borrowing. At the time of borrowing by the SPE, a government's external debt liability to the SPE is imputed equal to the amount of the SPE borrowing (the corresponding entry is an increase in the government's equity in the SPE), which is only extinguished when the SPE repays its debt. These entries are made symmetrically for both the government and the borrowing entity. The imputations do not affect the transactions or positions between the borrowing entity and its creditors, which are recorded as they occur with no imputations. The imputed government's external debt liability is to be included in the gross external debt position, and classified as general government debt under the appropriate debt instrument.

C

Collateralization of External Debt

To provide additional assurance to the creditor, the debtor may set aside either financial assets or future streams of income as collateral for the debt incurred. In other words, payments on the debt might be "backed" by future export earnings, such as receipts from petroleum sales, or the creditor may have a claim on certain financial assets held with third parties if the debtor defaults. Alternatively, the debtor might invest funds in a zero-coupon instrument that at maturity will equal the value of the principal debt incurred, which is then due for repayment. In all cases, external debt should be recorded gross, i.e., separately from the collateral. For instance, where the debtor has invested funds in a zero-coupon bond, both the external debt and the zero-coupon bond are recorded on a gross basis, the zero-coupon bond being an asset of the debtor. Also, when debt is contractually to be serviced by an income source of the debtor (e.g., future export earnings), the debtor continues to record the receipt of income and the payment of principal and/or interest even if the income is passed directly from "source" (e.g., the purchaser of the exports) to the account of the creditor, without directly involving the debtor. There may well be analytical interest in information on the value of external debt that has been collateralized, and in the type of financial asset or income stream used to back the external debt.

Consignment Trade

No debt is created for goods on consignment, i.e., goods intended for sale but not actually sold at the time of crossing a frontier, because ownership of the goods has not changed hands.

D

Defeasance

Defeasance is a technique by which a debtor unit removes liabilities from its balance sheet by pairing them with financial assets, the income and value of which are sufficient to ensure that all debt service payments are met. The *Guide* does not recognize defeasance as affecting the outstanding debt of the debtor as long as there has been no change in the legal obligations of the debtor. In other words, provided the payment obligations remain de jure with the original debtor, ownership of the liabilities remains unchanged, and should be reported as external debt of the original debtor. Defeasance may be carried out (1) by placing the paired assets and liabilities in a sep-

arate account within the institutional unit concerned or (2) by transferring them to another institutional unit. In the second case, debt defeasance leads to a change in the outstanding debt of the original debtor. If the two units are resident in the same economy, the sector classification of the debtor may change; if the second unit is resident of another economy a change in the gross external debt position of the economy of the original debtor will be recorded.

Deposits Jointly Held by Residents and Nonresidents

Some financial instruments have owners who are residents of different economies. The allocation of joint bank accounts, or other cases in which an account holder authorizes relatives to withdraw funds from the account, may be unclear. By convention, deposits of emigrant workers in their home economies that are freely usable by family members resident in the home economies are treated as being held by residents of the home economy; therefore, they are not external debt liabilities of the home economy. Similarly, deposits of emigrant workers in the host economy that are freely usable by family members are treated as being held by a resident of the host economy; therefore, they are not external debt liabilities of the host economy (see *BPM6*, paragraph 4.145). Compilers may adopt another treatment if better information is available.

Direct Investment: Intercompany Lending

Intercompany lending is used to describe direct investment debt positions between affiliated enterprises. It is not limited to loans. Intercompany lending is identified separately from other debt in the gross external debt position, and is classified under *Direct investment: Intercompany lending*. Although debt and other claims that do not involve voting power are not relevant to defining a direct investment relationship, they are included in direct investment transactions and positions if a direct investment relationship exists between the parties. Debt instruments—other than SDRs, interbank positions, and pension and related entitlements potentially—can be included in direct investment. Insurance technical reserves are included in direct investment when the parties are in a direct investment relationship. Debt between selected affiliated financial corporations is not classified as direct investment because it is not considered to be so strongly connected to the direct investment relationship. The financial corporations covered by this exception are: (1) deposit-taking corporations (both central banks and deposit-taking corporations, except the central bank); (2) investment funds; and (3) other financial intermediaries, except insurance corporations and pension funds (see *BPM6*, paragraph 6.28).

F

Fees on Security Lending and Gold Loans

Securities (equity or debt) and monetary gold are financial instruments, and thus, the fees for securities lending without cash collateral and gold loans are payments for putting a financial instrument at the disposal of another institutional unit. Accordingly, fees on securities lending and gold loans accrued to the security/gold owner are treated as interest (see *BPM6*, paragraph 11.68). The ability of the "borrower" to on-sell the securities (or gold) reflects that legal ownership is transferred to the borrower, while the economic risks and benefits of ownership remain with the lender (original owner). In return, the "lender" receives a fee from the "borrower" for the use of the security. In general, interest accrued and not yet payable, should be recorded with the financial liability on which it has accrued. However, for securities lending and gold loans fees, which are treated as interest by convention, the corresponding entries are classified in the gross external debt position as *other debt liabilities* (*other investment, other accounts receivable/payable-other* in the IIP) rather than with the instrument to which they relate.

Financial Intermediation Service Charges Indirectly Measured (FISIM)

In line with *2008 SNA*, the concept of FISIM is introduced in *BPM6*. Actual interest can be seen as including both an income element and a charge for a service. FISIM is the financial service compensated for by the margin between interest rate payable and the reference rate on loans and deposits involving financial corporations, even when lending their own funds (see *BPM6*, paragraphs 10.126–127). Therefore, actual interest payable by borrowers is partitioned

between a pure interest charge at the reference rate and the implicit service charge made by financial corporations. By convention, FISIM applies only to loans and deposits provided by, or deposited with, financial corporations. *BPM6* recommends that accrued interest not yet paid should be included in the outstanding amount of the financial asset or liability, rather than being classified separately (such as in other accounts receivable/payable-other), and that accrued interest not yet paid also includes FISIM accrued and not yet paid (see *BPM6*, paragraph 7.41). Thus, the generation of FISIM does not affect the gross external debt position. Interest due and not paid (arrears) recorded in the appropriate instrument also includes FISIM due and not paid. Interest payments recorded in the debt-service payment schedule include any FISIM element (see Chapter 6, footnote 19).

Financial Leases: Treatment of Residual Values

As explained in Chapter 3, under a financial lease, ownership of the underlying item is considered to have changed hands because the risks and rewards of ownership have, de facto, been transferred from the legal owner to the user; this de facto change of ownership is financed by a financial claim, which is the asset of the lessor and a liability of the lessee. However, even though the rentals may enable the lessor over the period of the contract to recover most of the costs of goods and the carrying charges, there may be a residual amount. The lessee may have an option to pay the residual value to gain legal ownership of the underlying item. How should the residual amount be recorded?

The residual amount is part of the debt obligation that arises when the goods are assumed to have changed ownership. In other words, under statistical convention, the debt at the inception of the lease is defined as the full value of the good, inclusive of the residual amount. This debt obligation is recorded as a *loan.* The loan liability arising from the residual value is extinguished either when the goods are returned or when a payment is made and legal ownership changes hands. (see *BPM6,* Appendix 6b, Box A6b. I for a numerical example of financial lease).

This issue also raises the question of whether there is a point at which the residual value is such a large percentage of the total value of the goods that the lease should be regarded as operational and not financial. There is no firm percentage; rather, these arrangements are determined more by their nature. When a lease is a financial arrangement, it is usually evident from the roles and obligations of the transactors, e.g., the lessee is responsible for repairs and maintenance, and the lessor is a financial institution, etc. (see also *BPM6*, paragraph 5.57).

Fundamental to the assumption of a change of ownership is the idea that, de facto, the lessee assumes the risks and rewards of ownership from the legal owner. But if there is option rather than agreement to purchase the residual value, or if it is agreed that the lessee will pay a market price for the residual amount, the greater the percentage size of the residual amount at inception, the more diminished the extent to which the de facto risks and rewards of ownership can be said to have changed hands.

G

Guaranteed External Debt

The provision by one institutional unit of a guarantee to make future debt-service payments to a nonresident creditor if certain conditions are met, such as a default by the debtor, does not negate the claim the creditor has on the debtor. Thus, the debtor on whom the nonresident creditor has a claim, and not the guarantor, should record an external debt liability, unless and until the guarantor assumes the external debt. Chapter 8 provides guidance on the classification of debt assumption.

I

Islamic Banking[2]

Activities of Islamic financial institutions differ from those of standard commercial depository corporations in that predetermined interest on financial transactions is prohibited. As is evident from the definition of external debt in Chapter 2, the nonpayment of interest on liabilities does not in itself preclude instruments from being classified as external debt.

[2] Islamic banking is described in detail in Appendix 2 of the IMF's MFSM (IMF, 2000), and in Annex 2 of the *Handbook of Security Statistics, Part I: Debt Securities Issues* (BIS, ECB, and IMF, 2009).

The classification of Islamic banking instruments as external debt, or not, can be determined by the following general guidance.

Islamic instruments—deposits include conventional and transferable deposits, such as Amanah and Qardhasan deposits—as well as various investment participation certificates that are not investments in the permanent capital of a financial institution and do not have the characteristics of negotiable securities.

Islamic instruments—debt securities consist of various investment participation certificates that have the characteristics of negotiable securities and are not an investment in the permanent capital of the issuer. Included in this category are the most negotiable investment certificates recorded as liabilities of a financial corporation.

Islamic instruments—loans cover arrangements in which a financial institution makes prepayments for clients, finances ventures or trade, or supplies working capital to clients. The arrangements may include short-term or other partnerships in which a financial institution is not making permanent, equity-type investments.

L

Lending to the Fund

The IMF maintains two standing multilateral borrowing arrangements—the expanded New Arrangements to Borrow (NAB) and the General Arrangements to Borrow (GAB). If the IMF considers that its forward commitment capacity might fall short of its member countries' needs, e.g., in the event of a major financial crisis, it can activate these arrangements.

The GAB is a long-standing credit arrangement under which 11 advanced economies stand ready to loan domestic currency to the IMF for the purpose of forestalling or addressing situations that could impair the international monetary system. The NAB is a set of credit arrangements with selected member countries, who stand ready to lend to the IMF. A contingent claim results from participation in the NAB or GAB, equal to the undrawn amount of credit. As noted, the IMF may require a member who participates in the NAB or in the GAB to lend to the IMF at short notice. When funds are actually lent, the member obtains a claim on the IMF that qualifies as a reserve asset, and should be included in the reserve position in the Fund. For more information on NAB and GAB see www.imf.org/external/np/exr/facts/gabnab.htm and the update of the *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template,* Appendix 8 (IMF, 2013).

In response to the financial crisis and following a call by the International Monetary and Financial Committee (IMFC) in April 2009, the IMF took a number of actions aimed at substantially increasing its lending resources. Additional arrangements under the umbrella of the General Resources Account include Bilateral Loan Agreements (BLA)—an agreement under which an IMF member commits to lending funds, usually in its domestic currency, up to an agreed limit, to the IMF, upon demand by the IMF—and Note Purchase Agreements (NPA)—an agreement under which an IMF member commits to purchasing an IMF promissory note from the IMF on demand, up to an agreed limit. Regarding Notes, two classes of notes were designed under the NPAs, Series A and Series B Notes.

M

Merchanting of Goods

Merchanting is defined as the purchase of goods by a resident of the compiling economy from a nonresident combined with the subsequent resale of the goods to another nonresident without the goods being present in the compiling economy (see *BPM6*, paragraph 10.41). For goods under merchanting, the acquisition of goods and the sales of goods are recorded at the time the change in economic ownership of goods occurs. External debt liabilities with nonresidents may arise from the external financing of goods under merchanting, in which case they should be included in the gross external debt position under the appropriate debt instrument.

Monetary Gold

Monetary gold is gold to which the monetary authorities (or others who are subject to the effective control of the monetary authorities) have title and is held as reserve assets. Monetary gold includes gold bullion and unallocated gold accounts with nonresidents that give title to claim the delivery of gold. Gold bullion takes the form of coins, ingots, or bars with a purity of at least 995 parts per 1,000, including such gold held in allocated gold accounts. See Gold Accounts: Allocated and Unallocated, in this appendix, Part 1.

Gold bullion included in monetary gold is a financial asset for which there is no corresponding liability, so no liability is included in external debt. Unallocated gold accounts do have a counterpart deposit liability (see paragraph 3.30). Unallocated gold account liabilities to nonresident monetary authorities are included in external debt.

Multiterritory Enterprises

A multiterritory enterprise has substantial activity in more than one economy and it is run as an indivisible operation with no separate accounts or decisions, so that no separate branches can be identified. Such enterprises may have operations including shipping lines, airlines, hydroelectric schemes on border rivers, pipelines, bridges, tunnels, and undersea cables. For multiterritory enterprises, it is necessary to prorate the total operations of the enterprise, as well as the enterprise's gross external debt position, into the individual economies. The factor used for prorating should be based on available information that reflects the contributions to actual operations, e.g., equity shares, equal splits, or splits based on operational factors such as tonnage or wages (see *BPM6*, paragraph 4.43) could be considered. Compilers in each of the territories involved are encouraged to cooperate in order to develop consistent data, avoid gaps, and minimize respondent and compilation burden, as well as assist counterparties to report bilateral data on a consistent basis.

N

Nonresident Deposits

Because of exchange control or other restrictions, nonresident deposits in domestic banks may not be transferable out of the economy. Such restrictions may be introduced after the deposits have been made or may have been established when the accounts were opened. All such nonresident deposit claims on resident banks should be classified as external debt. Nonetheless, if the amounts are significant and are of analytical interest in their own right, it is recommended that additional information be provided.

O

On-Lending of Borrowed Funds

An institutional unit within an economy might borrow funds from a nonresident(s) and then on-lend the funds to a second institutional unit within the economy. In such instances, the first institutional unit, i.e., the institutional unit that borrowed from the nonresident(s), should record an external debt liability, with any subsequent on-lending classified as a domestic claim/liability. As set out in Chapter 2, the decisive consideration is whether the creditor has a claim on the debtor, and in this example the nonresident creditor has a claim on the first institutional unit.

If an institutional unit within an economy borrowed from a nonresident(s) and on-lent the funds to a nonresident, the unit should record both external debt and an external claim. The nonresident borrower would also record an external debt liability in that economy's measure of external debt.

Overnight Deposits

Overnight deposits (or sweep accounts) involve funds that are moved back and forth overnight. In some cases, these overnight accounts are a liability to a nonresident. The funds are returned at the beginning of the next working day and may then be moved back at the close of business. Positions should be measured at the end of the day after the funds are moved from the first to the second economy and not after they are returned to the first economy the next working day. The calculation of external liability positions can differ substantially depending on whether they are measured before, or after, funds are moved. By measuring positions after the funds have been moved, consistency is ensured between the measure of interest flows and of positions. In addition, major data users are interested in the size and location of these stocks for risk assessment and other purposes.

P

Part-Payments for Capital Goods

See *Progress Payments for High-Value Capital Goods*.

Penalties Arising from Commercial Contracts

Under the terms of a commercial contract, one party (resident) may be required to compensate another party (nonresident) (i.e., pay a penalty) in the event of the first party failing to meet its obligations, or some of its obligations, under the contract. Once the penalty is owed and until it is paid to the nonresident,

it is external debt, and recorded under other debt liabilities. The debt should be recorded from the time when the resident becomes liable under the contract for the penalty.

Prepayments of Goods and Services

When an importer makes a prepayment to an exporter for goods and services, the exporter has a liability to the importer that remains outstanding until ownership of the goods changes hands or the service is provided. Similarly, when an importer makes a postpayment some time after he acquires goods or services, the importer has a liability to the exporter that remains outstanding until the postpayment is made. These liabilities should be recorded as debt liabilities because future payments are required; in the case of the prepayment, the principal amount outstanding is repaid in goods or in a service provided, whereas in the case of the postpayment, it is likely that a financial payment will be made, although in the instance of barter, goods or services may be provided to extinguish the debt. Unless the prepayment is for more than one year hence, these debt liabilities should be recorded as *short term, trade credit and advances*.

Processing of Goods

Manufacturing services on physical inputs owned by others—known as goods for processing—covers processing, assembly, labeling, packing, etc., undertaken by enterprises that do not own the goods concerned but are paid a fee by the owner. In these cases, the ownership of the goods does not change, so no general merchandise transaction is recorded between the processor and the owner. Therefore, there are no corresponding imputed liabilities related to these transactions to be recorded because there is no imputation of a change of ownership of the goods. In other words, external debt liabilities recorded under trade credit and advances (or under *Direct investment: Intercompany lending*, if applicable) are not required for goods for processing.

Progress Payments for High-Value Capital Goods

The production of high-value capital goods such as ships, heavy machinery, and other structures may take several months or years to complete. In *BPM6*, when a contract of sale is agreed in advance for the construction of such products, a progressive change of ownership may occur for the work-in-progress. When the contract calls for stage payments (progress payments, also known as part-payments), the transaction values may often be approximated by the value of the stage payments made each period, although a difference in timing between the change of ownership and progress payment may give rise to trade credit and advances. Therefore, progress payments are not to be recorded as trade credit and advances debt of the exporter, unless there is a difference in timing between the change of ownership and progress payments.

Project Loans: Disbursements

Disbursements of project loans can take the following form:

- Advances to the borrowing entity—disbursements are to be recorded when the lender advances funds to the borrower
- Direct payment by the lender to suppliers of goods and services—disbursements are to be recorded when the lender pays the supplier
- On a reimbursement basis after the borrower has already paid the suppliers—disbursements are to be recorded when the lender makes reimbursements to the borrower

Public-Private Partnerships (PPPs)

Public-private partnerships (PPPs) typically involve the government and a private corporation agreeing to a long-term contract under which the private corporation constructs and operates fixed-assets of a kind that are usually the responsibility of the general government sector, or public corporations. These commonly include, e.g., roads, bridges, water supply and sewerage treatment works, hospitals, prison facilities, electricity generation and distribution facilities, and pipelines. In many such instances, such transactions are likely to be classified as resident to resident, particularly if the private corporation creates a separate unit to construct and/or operate the asset (although in such instances that unit may incur external debt liabilities to its nonresident parent, which need to be recorded).

If the private sector corporation is a nonresident, the classification of the transactions as external debt

depends on who is the economic owner of the fixed asset during the contract period and the nature of the contract. PPPs projects are often complex and the specific contract needs to be taken into account. Detailed advice on different arrangements, with numerical examples, is provided in the *PSDS Guide* (paragraphs 4.123–4.126). For the purposes of this *Guide* some general principles for recording external debt are provided:

- Where an asset is constructed by, and the economic ownership remains with, a nonresident private corporation until transferred to government on completion of the contract, any prepayments for the asset by the government are claims on a nonresident enterprise, i.e., external debt of the private nonresident corporation. If the government only pays the private nonresident corporation and obtains economic ownership on completion, and needs to borrow abroad to finance this purchase, then the government will incur external debt when it borrows.
- Where there are lease arrangements between the government and a nonresident private corporation, these are classified in the normal way as operating or financial leases, and hence external debt or not, depending on whether the government or private corporation gains most of the risks and benefits of ownership as a result of the contracts entered into. For instance, if the private corporation continues to legally own the asset but the government makes payments both to cover the costs of operating the asset and to meet the financing costs, then a financial lease, and hence external debt, arises for the government and should be recorded as such.
- If the government is assessed as the economic owner of the asset during the contract period but does not make any explicit payments to the private nonresident corporation, a financial lease is imputed, hence external debt for the government (see also *PSDS Guide*, paragraph 4.125).

As with all financial leases, at the time of effective change of ownership, the market value of the good is recorded and represents the external debt of the government. The payments to be made need to be separated into operating and financing costs. If a market value is available, the total amount paid in financing costs over the life of the lease in relation to that price will determine the implicit rate of interest on the loan. Otherwise, the financing costs discounted by a representative interest rate of the government—the present value of the finance payments—could represent the market value of the asset in the absence of other information, and generate data on the future interest and principal payments—examples 1 and 2 in the appendix of Chapter 2, provide calculations that illustrate the principles involved.

R

Reinsurance

Positions arising from reinsurance are treated in the same way as those arising from insurance.

For reinsurance relating to life insurance, any technical reserves held by insurance companies that are assets of nonresident policyholders are external debt of the insurance company. As with claims of households in life insurance companies, any such external debt should be included under *other debt liabilities* in the gross external debt position.

For nonlife insurance, prepayment of premiums by nonresidents, and reserves held against claims of nonresidents that have arisen, are also external debt. In both instances, any such external debt is included under *other debt liabilities* (see also *Insurance, Pension, and Standardized Guarantee Schemes* in Part I of this Appendix above).

Repurchase Agreements: Delay in Returning the Security

If the security taker fails to return the security to the security provider, then the recording treatment depends on whether the failure is simply a delay or whether there is a default. If the failure is due to a delay (e.g., the result of another party in the chain of repo securities being unable to access the specific security at that particular date), it has no impact on the gross external debt position, although in line with common market practice the security provider may retain the funds without paying any interest. If there is a default, usually under the terms of the reverse agreement the security provider's loan liability to the security taker is extinguished—the security taker no longer has a claim on the security provider. If the security provider defaults on returning the cash, then the security pro-

vider's security holdings fall, and those of the security taker increase, and the loan is extinguished. In either event, because the security provided is likely to be of greater value than the cash provided, residual claims may still continue to exist.

Reserve Position in the IMF

Reserve position in the IMF is a component of *reserve assets* and is the sum of (1) the "reserve tranche," i.e., the foreign currency (including SDRs) amounts that a member country may draw from the IMF at short notice; and (2) any indebtedness of the IMF (under a loan agreement) in the General Resources Account that is readily available to the member country, including the reporting country's lending to the IMF under the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB). (See *BPM6*, paragraphs 6.85 and 7.77–7.78 for more information).

S

Sovereign Wealth Funds

Some governments create special purpose government funds, usually called sovereign wealth funds (SWFs). Created and owned by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The funds are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports (see *BPM6*, paragraphs 6.93–6.98 for more information on SWFs).

The classification of an SWF controlled by government in the general government or financial corporations sectors is determined according to the criteria set out in *BPM6*, paragraph 4.92, i.e., government-controlled enterprises that (1) produce market output (i.e., charge prices that are economically significant), and (2) have complete sets of accounts, are excluded from general government and are included as public enterprises in the financial corporations sector—in the case of SWFs. If the fund is an entity incorporated abroad or is a quasi-corporation located abroad, it is classified as a separate institutional unit in the financial corporations sector resident in its economy of incorporation.

T

The Value of Debt After Consolidation Is Greater Than the Value of the Consolidated Debts Combined

If the terms of a loan are changed, a new contract is created. Thus, if two or more old debts are consolidated into one debt, the new debt replaces the two or more old debts and is classified by type of instrument (loan, security, etc.). If the total value of the new debt is greater than the old debts combined, e.g., because of extra charges arising from rescheduling, the gross external debt position increases.

Trading of Non-negotiable Instruments that are Recorded at Nominal Values in Positions

Nominal valuation is used for positions in nonnegotiable instruments—such as loans, deposits, and trade credit and advances (see paragraph 2.38). However, nonnegotiable debt instruments may be sold—without becoming negotiable instruments—by the creditor to a third party, with the sale value often being less than the nominal value, because, for instance, the market price takes account of the possibility of default. Where there is a difference between the sale value and the nominal value of the instrument, the debt instrument continues to be recorded at the nominal value in external debt statistics. For the new creditor, the difference in value is recorded as a revaluation in the flow data (see *BPM6*, paragraph 9.33).