# **EXTERNAL DEBT**

# **STATISTICS**

# **GUIDE FOR COMPILERS AND USERS**

# **DRAFT FOR WORLDWIDE COMMENTS**

# PART I: CONCEPTUAL FRAMEWORK (CHAPTERS 2–9)

# AND APPENDICES I, III, AND VII

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# 2. THE MEASUREMENT OF EXTERNAL DEBT: DEFINITION AND CORE ACCOUNTING PRINCIPLES

### A. Introduction

2.1. This chapter begins by presenting the definition of external debt consistent with the concepts of the 2008 SNA and BPM6. The definition of external debt is based on the notion that if a resident has a current liability to a nonresident that requires payments of principal and/or interest in the future, this liability represents a claim on the resources of the economy of the resident, and so is external debt of that economy. Such an approach provides a comprehensive measure of external debt across the range of debt instruments regardless of how they may be structured. The focus of the definition is on gross liabilities—that is excluding any assets.

2.2. A common theme throughout the *Guide* is that analysis of the gross external debt position of an economy requires information that, as far as possible, is compatible with related data series both within and among countries. Compatibility enhances the analytical usefulness and the reliability of data by allowing interrelationships with other related macroeconomic data series to be examined and comparisons across countries to be undertaken on a clear and consistent basis. Also, compatibility encourages the rationalization of collection procedures, through the integration of domestic and external debt data (thus lowering of the costs of data production). For these reasons, this chapter introduces accounting principles for the measurement of external debt that are drawn from the 2008 *SNA* and *BPM6*.

## **B.** Definition of External Debt

2.3. The Guide defines gross external debt as follows: Gross external debt, at any given time, is the outstanding amount of those actual current, and not contingent, liabilities that require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to nonresidents by residents of an economy.

### **Outstanding and Actual Current Liabilities**

2.4. For a liability to be included in external debt it must exist and be outstanding. The decisive consideration is whether a creditor owns a claim on the debtor. Debt liabilities are typically established through the provision of economic value—that is, assets (financial or nonfinancial including goods), services, and/or income—by one institutional unit, the creditor, to another, the debtor, normally under a contractual arrangement that specifies the terms and conditions of the payment(s) to be made.<sup>1</sup> Debt liabilities can also be created by

<sup>&</sup>lt;sup>1</sup> In many instances, such as cash purchases by households in shops, economic value is provided against immediate payment, in which instance no debt liability is created.

the force of law,<sup>2</sup> and by events that require future transfer payments.<sup>3</sup> Debt liabilities include arrears of principal and interest. Commitments to provide economic value in the future cannot establish debt liabilities until items change ownership, services are rendered, or income accrues; for instance, amounts yet to be disbursed under a loan or export credit commitment are not to be included in the gross external debt position.

#### **Principal and Interest**

2.5. The amount the debtor owes to the creditor is known as the principal amount. The provision of economic value by the creditor, or the creation of debt liabilities through other means, establishes a principal liability for the debtor which, until extinguished, may change in value over time. For debt instruments, for the use of the principal, interest can (and usually does) accrue on the principal amount, resulting in an interest cost for the debtor. When this cost is paid periodically, as commonly occurs, it is known in the *Guide* as an interest payment. All other payments by the debtor to the creditor that reduce the principal amount outstanding are known as principal payments.

2.6. For long-term debt instruments (that is, with an original maturity of more than one year), interest costs paid periodically are defined as those to be paid by the debtor to the creditor annually or more frequently. For short-term debt instruments (that is, with an original maturity of one year or less), interest costs paid periodically are defined as those to be paid by the debtor to the creditor before the redemption date of the instrument.

2.7. The definition of external debt does not distinguish between whether the payments that are required are principal or interest, or both. For instance, interest-free loans are debt instruments although no interest is paid, while perpetual bonds are debt instruments although no principal is to be repaid. In addition, while it may normally be expected that payments of principal and interest will be made in the form of financial assets, such as currency and deposits, the definition does not specify the form in which payments need to be made. For instance, payments could be made in the form of goods and services. It is the future requirement to make payments, not the form of those payments, that determines whether a liability is a debt instrument or not.

2.8. Also, the definition does not specify that the timing of the future payments of principal and/or interest need be known for a liability to be classified as debt. In many instances, the schedule of payments is known, such as on debt securities and loans<sup>4</sup>. However, in other instances the exact schedule of payments may not be known. For example, the timing of payment might be at the demand of the creditor, such as non-interest-bearing demand deposits; the debtor may be in arrears, and it is not known when the arrears will actually be paid; or the timing of a payment may depend on certain events, such as the

 $<sup>^2</sup>$  These liabilities could include those arising from taxes, penalties (including penalties arising from commercial contracts), and judicial awards at the time they are imposed. However, in some instances an issue will arise about whether a government has jurisdiction to impose such charges on nonresidents.

<sup>&</sup>lt;sup>3</sup> These include claims on nonlife insurance companies, claims for damages not involving nonlife insurance companies, and claims arising from lottery and gambling activity.

exercise of an embedded put (right to sell) or call (right to buy) option. Once again, it is the requirement to make the payment that determines whether the liability is debt, rather than the timing of the payment. So, the liabilities of pension funds and life insurance companies to their nonresident participants and policyholders are regarded as debt of those institutions because at some point in time a payment is due, even though the timing of that payment may be unknown.

#### Residence

2.9. To qualify as external debt, the debt liabilities must be owed by a resident to a nonresident. Residence is determined by where the debtor and creditor have their center of predominant economic interest—typically, where they are ordinarily located—and not by their nationality. The definition of residence is explained in more detail later in this chapter and is the same as in the *BPM6* and 2008 *SNA*.

#### **Current and Not Contingent**

2.10. Contingent liabilities are not included in the definition of external debt. These are defined as arrangements under which one or more conditions must be fulfilled before a financial transaction takes place.<sup>5</sup> Contingent liabilities can be explicit or implicit.<sup>6</sup> Such liabilities may involve a legal contract specifying that one party is obliged to provide a payment or series of payments to another unit only if certain specified conditions prevail. However, from the viewpoint of understanding vulnerability, there is analytical interest in the potential impact of contingent liabilities on an economy and on particular institutional sectors, such as the general government or financial corporations. Of particular relevance is that the amount of external debt liabilities that an economy potentially faces may be greater than is evident from the compiled and published external debt data if cross-border guarantees have been given. Indeed, the *Guide* encourages countries to set up systems to monitor and disseminate data on explicit contingent liabilities, as is discussed in more detail in Chapter 9.

#### Relationship with Instruments in the 2008 SNA

2.11. From the viewpoint of the national accounts, the definition of external debt is such that it includes all liabilities recognized by the *2008 SNA*—except for equity (both equity shares and other equity) and investment fund shares and financial derivatives and employee stock options (ESOs)—that are owed by residents to nonresidents. These liabilities, known as debt liabilities, comprise the following debt instruments: Special Drawing Right (SDR) allocations, currency and deposits (including unallocated gold accounts), debt securities, loans, insurance, pension, and standardized guarantees schemes, trade credit and advances, and other accounts payable. Equity and investment fund shares, and other equity, are excluded from debt liabilities because they do not require the payment of principal or interest. For the same reason, financial derivatives, both forwards and options, and ESOs are excluded—no principal amount is advanced that is required to be repaid, and no interest

<sup>&</sup>lt;sup>5</sup> The exclusion of contingent liabilities does not mean that guaranteed debt is excluded, but rather that the guaranteed debt is attributed to the debtor not the guarantor (unless and until the guarantee is called).

<sup>&</sup>lt;sup>6</sup> For additional information regarding explicit and implicit contingent liabilities see Chapter 9.

accrues on any financial derivative instrument. Forward-type contracts (forwards), option contracts (options), and ESOs are described in more detail in Chapter 3. Nonetheless, an overdue obligation to settle a financial derivatives contract would, like any arrears, be a debt liability because a payment is required. Gold bullion held as monetary gold<sup>7</sup> is a financial asset included in the *2008 SNA* but is not a debt instrument because it is, by convention, an asset without a corresponding liability.

### C. Core Accounting Principles

2.12. This section considers the concepts of flows and positions, residence, time of recording, valuation, the unit of account and exchange rate conversion, and maturity. Unless otherwise specified, these concepts are applicable throughout the *Guide*.

#### **Flows and Positions**

2.13. Flows refer to economic actions and effects of events within a period, and positions refer to a level of financial assets or liabilities at a point in time. Flows and positions are integrated so that all changes in positions between two points in time are fully explained by the recorded flows. The *Guide* focuses primarily on positions. Nonetheless, it is important where feasible to reconcile flows and positions, not least to ensure the reliability of the positions data.

2.14. Flows reflect the creation, transformation, exchange, transfer, or extinction of economic value; they involve changes in the volume, composition, or value of an institutional unit's assets and liabilities. Flows consist of those that are associated with transactions and other flows. A transaction is an interaction between two institutional units that occurs by mutual agreement or through the operation of the law and involves an exchange of value or a transfer. Other flows are changes in the volume, value, or classification of an asset or liability that do not result from a transaction between a resident and a nonresident. These include, for example, revaluations (holding gains and losses) on an asset or liability that arises from changes in their price and/or the exchange rates.

#### Residence

2.15. Debt liabilities of residents that are owed to nonresidents are to be included in the presentation of an economy's gross external debt position. Debt liabilities owed to residents are excluded. Hence the definition of residence is central to the definition of external debt. In the *Guide*, as in the *BPM6* and *2008 SNA*, an institutional unit—that is, an entity such as a household, corporation, government agency, etc., that is capable, in its own right, of owning assets, incurring liabilities, and engaging in economic activities and in transactions with other entities—is a resident of an economy where it has its strongest connection, expressed as its center of predominant economic interest in the economic territory of that economy.

2.16. To define residence, the terms "economy", "economic territory", and "center of predominant economic interest" also require definitions. An economy consists of all the

<sup>&</sup>lt;sup>7</sup> For definition of monetary gold, see Appendix I, part 2.

institutional units that are resident in a particular economic territory. The most commonly used concept of an economic territory is the area under the effective economic control of a single government.<sup>8</sup> Economic territory can be any geographic area or jurisdiction for which statistics are required and includes<sup>9</sup> the land area including islands, airspace, territorial waters and territorial enclaves (such as embassies, consulates, military bases, scientific stations, information or immigration offices, aid agencies, and central bank representative offices with diplomatic status that have immunity from the laws of the host territory) physically located in other territories. Economic territory has the dimensions of physical location as well as legal jurisdiction, so that corporations created under the law of that jurisdiction are part of that economy. The economic territory also includes special zones, such as free trade zones and offshore financial centers. These are under the control of the government so are part of the economy, even though different regulatory and tax regimes may apply. The economic territory excludes international organizations and enclaves of other governments that are physically located in the territory. Another type of economic territory is a currency or economic union.<sup>10</sup>

2.17. An institutional unit has a predominant center of economic interest and is a resident unit of an economy when, from some location (dwelling, place of production, or other premises) within the economic territory of the economy, the unit engages and intends to continue engaging (indefinitely or for a finite but long period of time) in economic activities and transactions on a significant scale. The location need not be fixed as long as it remains within the economic territory. For statistical purposes, the conduct or intention to conduct economic activities for a year or more in an economic territory normally implies residence of that economy. The one-year period is used as an operational definition, and it is adopted to avoid uncertainty and facilitate international consistency.

2.18. In essence, an institutional unit is a resident of the economy in which it is ordinarily located. Thus, a branch or subsidiary is resident in the economy in which it is ordinarily located, because it engages in economic activity and transactions from that location, rather than necessarily the economy in which its parent corporation is located. Unincorporated site offices of major construction and similar projects, such as oil and gas exploration, that take over a year to complete and are carried out and managed by nonresident enterprises will, in most instances, meet the criteria of resident entities in the economy in which they are located, and so can have external debt (although the claims on the office by the parent might well represent an equity investment).<sup>11</sup> When a nonresident entity has substantial operations over a significant period in an economic territory, but no separate legal entity for those operations, a branch may be identified as an institutional unit. This unit is identified for statistical purposes because the operations have strong connection to the location of operations in all ways other than incorporation.

<sup>&</sup>lt;sup>8</sup> The definition of economic territory no longer has the requirement that persons, goods, and capital circulate freely as previously indicated in the *BPM5*.

<sup>&</sup>lt;sup>9</sup> See 2008 SNA, paragraphs 4.10 and 26.26, and BPM6, paragraph 4.5.

<sup>&</sup>lt;sup>10</sup> For references of currency and economic unions see *BPM6*, Appendix 3.

<sup>&</sup>lt;sup>11</sup> The classification of parent claims on unincorporated branches is discussed in more detail in Chapter 3, in the section on direct investment.

2.19. The residence of enterprises in free trade and other offshore zones—including those engaged in the assembly of components manufactured elsewhere, those engaged in trade and financial operations, and those located in special zones—is attributed to the economies in which they are located. For instance, in some countries, banks, including branches of foreign banks that are licensed to take deposits from and lend primarily, or even only, to residents of other economies are treated as "offshore banks" under exchange control and/or other regulations. These banks usually face different supervisory requirements and may not be required to provide the same amount of information to supervisors as "onshore" banks. Nonetheless, the liabilities of the offshore banks should be included in the external debt statistics of the economy in which they are located, provide that the liabilities meet the definition of external debt.

Similar issues can arise with special purpose entities (SPEs) or vehicles, international 2.20. business companies, shell companies, shelf companies, and brass plate companies. These entities may have little or no physical presence in the economy in which they are legally incorporated or legally domiciled (for example, registered or licensed) and any substantive work of the entity may be conducted in another economy. In such circumstances, there might be debate about where the predominant center of economic interest for such entities lies. These entities are always treated as separate institutional units if they are resident in a different territory to that of their owners. The *Guide* attributes external debt to the economy in which the entity-that has the liabilities on its balance sheet, and so on whom the creditor has a claim-is legally incorporated, or in the absence of legal incorporation, is legally domiciled. So, debt issues on the balance sheet of entities legally incorporated or domiciled in an offshore center are to be classified as external debt of the economy in which the offshore center is located. Any subsequent on-lending of the funds raised through such debt issues to a nonresident, such as to a parent or subsidiary corporation, is classified as an external asset of the offshore entity and external debt of the borrowing entity. In line with BPM6 a multiterritory enterprise is defined as an enterprise that 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. For multiterritory enterprises, it is necessary to prorate the enterprise's gross external debt position, into the individual economies (see the treatment of the gross external debt position of these enterprises in Appendix I, Part II).

2.21. In some economies, separate identification of the gross external debt (and external assets) of resident "offshore banks" and other "offshore entities" is necessary because of the potential size of their liabilities relative to the rest of the economy.

2.22. In contrast, a nonresident may set up an agency in the resident economy usually to generate business in that economy. So, for instance, a resident agent may arrange for its parent foreign bank to lend funds to a fellow resident (the borrower). Unless the agent takes the transactions between the borrower and the creditor bank onto its own balance sheet, the borrower records external debt and not the agent. This is because the debtor/creditor relationship is between the lending bank and the borrower and lender together. If the agent does take the transactions onto its balance sheet then it, not the final borrower, should record external debt from its parent foreign bank.

2.23. International organizations are entities established by formal political agreements among their members that have the status of international treaties; their existence is recognized by legal provisions in their member countries. International organization may be global or regional. International organizations are treated as not being resident of the territories in which they are located. This treatment is because they are generally exempted from, or are only partially subject to, national laws and regulations, and so they are not considered to be part of the national economy of the territory, or territories, in which they are located. The *Guide* attributes debt liabilities of an international financial organization as external debt of this institutional unit.

2.24. A currency union central bank is an international financial organization that acts as a common central bank for a group of member countries. Such a bank has its headquarters in one country and usually maintains national offices in each of the member countries. Each national office acts as central bank for that country and is treated as a resident institutional unit in that country. The headquarters, however, is an international organization, and thus a nonresident from the perspective of the national central banks. However, for statistics relating to the economic territory of the whole group of member countries, the currency union central bank is a resident institutional unit of this economic territory.

## **Time of Recording**

2.25. The guiding principle for whether claims and liabilities exist and are outstanding is determined at any moment in time by the principle of ownership. The creditor owns a claim on the debtor, and the debtor has a liability to the creditor.<sup>12</sup> The *Guide* recommends use of the accrual basis for recording of flows (transactions and other changes in financial assets and liabilities). The accrual basis matches the time of recording with the timing of events giving rise to the actual resource flows. The accrual basis provides the most comprehensive information because all resources flows are recorded, including nonmonetary transactions, imputed transactions, and other flows. Such comprehensive recording ensures the integration of flows and stocks. The change of economic ownership is central in determining the time of recording on an accrual basis for transactions. A change in the ownership from the economic point of view means that all risks, rewards, and rights and responsibilities of ownership in practice are transferred.

2.26. When a transaction occurs in financial assets, the date of the change of ownership (the value date), and so the day the position is recorded, is when both creditor and debtor have recorded the claim and liability, respectively, in their books. This date may actually be specified to ensure matching entries in the books of both parties. If no precise date can be fixed, the date on which the creditor acquires the financial claim or receives payment is decisive. For example, loan drawings are entered in the accounts when actual disbursements are made, and so when financial claims are established, and not necessarily when an agreement is signed.

2.27. For other transactions, when a service is rendered, interest accrues, or an event occurs that creates a transfer claim (such as under nonlife insurance), a debt liability is

<sup>&</sup>lt;sup>12</sup> Thus, the *Guide* does not recognize any unilateral repudiation of debt by the debtor.

created and exists until payment is made or forgiven. Although not usual, like interest, service charges can accrue continuously. Although equity securities are not debt instruments, dividends once the shares go ex-dividend are recorded as *other debt liabilities*<sup>13</sup> until they are settled.<sup>14</sup> Consistent with the accrual principle, an overdue obligation to settle a financial derivative contract is reclassified to a debt liability because of the change in the nature of the claim.

2.28. The *Guide* recommends that interest costs accrue continuously on debt instruments, thus matching the cost of capital with the provision of capital. This recommendation is consistent with the approach taken in related international statistical manuals and in commercial accounting standards (see Box 2.1). For interest costs that accrue in a recording period, there are three measurement possibilities: (1) they are paid within the reporting period, in which instance there is no impact on the gross external debt position; (2) they are not paid because they are not yet payable (referred to hereafter as "interest costs that have accrued and are not yet payable")— for example, interest is paid each six months on a loan or security, and the gross external debt position is measured after the first three months of this period—in which instance the gross external debt position increases by the amount of interest costs that have accrued during the three-month period; and (3) they are not paid when due, in which instance the gross external debt position increases by the amount of interest costs that have accrued during the period and are in arrears at the end of the period.

#### Interest costs that have accrued and are not yet payable

2.29. The *Guide* recommends including interest costs that have accrued and are not yet payable as part of the value of the underlying debt instruments. That is, the accrual of interest costs not yet payable continuously increases the principal amount outstanding of the debt instrument until these interest costs are paid. This is consistent with the approach in the *BPM6* and the *2008 SNA*. It is recognized that the recording of interest accruing on deposits and loans for some economies may have to follow national practices and be classified under other debt liabilities.

2.30. When debt securities, such as bonds (including deep-discount and zero-coupon bonds), bills, and similar short-term securities are issued at a discount (or at a premium), the difference between the issue price and its face or redemption value at maturity is treated, on an accrual basis, as interest (negative interest) over the life of the instrument. When issued at a discount, the interest costs that accrue each period are recorded as being reinvested in the debt security, increasing the principal amount outstanding. This approach can be described as the capitalization of interest; it is not a holding gain for the security owner. When issued at a premium, the amount accruing each period reduces the value of the debt security.

<sup>&</sup>lt;sup>13</sup> In the *Guide*, other debt liabilities include insurance, pension, and standardized guarantee schemes, and other accounts payable-other (see paragraph 3.3).

<sup>&</sup>lt;sup>14</sup> The ex-dividend date is the date the dividends are excluded from the market price of shares.

#### Arrears

2.31. Arrears occur when principal and/or interest payments are not made when due, such as on a loan. When arrears (including interest that accrues on arrears) occur, they should continue to be shown in the same debt instrument until the liability is extinguished. The nonpayment, when due, of principal and/or interest leaves the external debt position unchanged. Arrears should continue to be reported from their creation—that is, when payments are not made<sup>15</sup>—until they are extinguished, such as when they are repaid, rescheduled, or forgiven by the creditor.<sup>16</sup>

#### Box 2.1. The Choice of a Recording Basis: The Case for Accrual Accounting<sup>1</sup>

#### Meaning of the Term "Recording Basis"

In the context of a macroeconomic statistical system, recording bases are defined mainly according to the time at which transactions are recorded in that system. Alternative recording bases are possible because for many transactions, there can be a time lag between the change of ownership of the underlying item, the due date for payment, and the actual date for payment. Also, given the nature of the different recording bases, the transactions and positions captured by them will also differ. Thus, an important consideration in choosing a recording basis is the information intended to be conveyed in the statistical system. For external debt statistics, the intention is to provide users of these data with a comprehensive measure of external debt liabilities at the end of the reporting period, and to allow them to identify the types of flows during the reporting period that affect the size and composition of these liabilities. Consequently, the *Guide* recommends the use of the accrual recording basis, for reasons explained below.

#### Main Types of Recording Bases

Three types of recording bases have most commonly been used in macroeconomic statistical systems: cash basis, due-for payment basis, and accrual basis . In practice, variations on each of these main bases are often found.

With cash recording basis, transactions are recorded when a payment is made or received, irrespective of when the assets involved change ownership. In its strictest form, only those transactions that involve cash as the medium of exchange are included (that is, cash inflows and outflows). The positions recorded at the end of the reporting period in such a system are restricted to cash balances. Nevertheless, in practice, cash recording basis is often modified to include other balances such as debt balances. In other words, when cash is disbursed on a debt instrument, an outstanding debt position is recorded, and subsequent repayments of principal, in cash, reduce that outstanding debt. For cash recording basis, the times at which payments take place may diverge significantly from the economic activities to which they relate and it is these underlying activities and transactions that this *Guide* and other macroeconomic statistical systems seek to portray. Moreover, cash recording basis does not apply to nonmonetary transactions.

A due-for-payment recording basis records transactions when receipts or payments arising from the transaction fall due, rather than when the cash is actually received or paid. If a payment is made before it is due, then the transactions are recorded when the cash payment is made. The due-for payment basis can be considered as a modification of the cash basis. In addition to cash balances, the due-for-payment basis

<sup>&</sup>lt;sup>15</sup> In some instances, arrears arise for operational reasons rather than from a reluctance or inability to pay. Nonetheless, in principle such arrears, when outstanding at the reference date, should be recorded as arrears.

<sup>&</sup>lt;sup>16</sup> Data on arrears are important in their own right, and should be presented as memorandum items, where significant (see selected tables in Chapters 4, 5 and 7).

takes into account amounts due or overdue for payment. Typically, a due-for-payment recording basis will record debt based on the redemption amount of the outstanding liability—the amount due for payment at maturity. This amount may differ from the amount originally disbursed for a variety of reasons, including discounts and premiums between the issue and redemption price, repayment of principal, and revaluation of the debt due to indexation. In addition, this recording basis will capture debt arising from some noncash transactions, such as nondebt arrears and the assumption of debt from one entity to another (for example, to the general government).

On an accrual recording basis, transactions are recorded when economic value is created, transformed, exchanged, transferred, or extinguished. Claims and liabilities arise when there is a change of ownership. The accrual reporting basis thus recognizes transactions in the reporting period in which they occur, regardless of when cash is received or paid, or when payments are due. Gross external debt positions at the end of a reporting period depend on the gross external debt position at the beginning of the period, and transactions and any other flows that have taken place during the period.<sup>2</sup> The accrual recording basis records what an entity owes from the perspective of economic, not payment, considerations.

The different approaches of the three recording bases can be illustrated by the example of a loan, on which interest costs are paid periodically until the loan is repaid at maturity. The initial cash disbursement would be recorded in all three recording bases at the same time—that is, when the disbursement is made. All three systems would record a debt liability.<sup>3</sup> However, on an accrual reporting basis, interest costs are recorded as accruing continuously, reflecting the cost of the use of capital, and increasing the outstanding amount of the debt liability during the life of the loan, until the interest costs become payable. However, on a cash or due-for-payment basis, no such increase would arise.

Interest payments and repayment of principal at maturity are recognized at the same time in all three systems, provided that these payments are made in the reporting period in which they are due. For positions, on a cash basis, only amounts disbursed in cash and repaid in cash are taken into account; on a due-for-payment basis, amounts disbursed and repaid in cash are recognized along with any outstanding liabilities arising from noncash transactions; the accrual recording basis, in contrast, recognizes all existing liabilities regardless of whether cash has been disbursed or repaid, or payment is due or not.

#### **Measuring External Debt Positions**

#### Disadvantages of Cash and Due-for-Payment Bases

Both the cash and the due-for-payment bases have deficiencies in providing a comprehensive measure of gross external debt positions.

The cash recording basis contains information "only" on debt transactions arising from cash transactions; noncash transactions are not covered (for example, the provision of goods and services on which payment is delayed). Thus, it provides insufficient coverage of external debt. Though the due-for-payment basis, as an extension of the cash basis, includes noncash transactions such as indexation, it still provides an incomplete measure of external debt. For instance, on a due-for-payment recording basis, payments not yet due for goods and services already delivered are not considered debt (unless, for example, there is a contractual agreement to extend trade credit). In addition, interest is not recorded until due for payment, regardless of whether interest is in the form of a discount to the face value on issuance or in the form of interest payments (that is, paid periodically).

#### Advantage of an Accrual Basis

The accrual recording basis, which has long been used as the basis for commercial accounting, provides the most comprehensive information of the bases described, because it measures external debt based on whether a creditor has ownership of a financial claim on a debtor. The accrual basis provides the most consistent measure of external debt, both in terms of coverage and size, in that it is indifferent (1) to the form of payment—debt can be created or extinguished through cash and/or noncash payments (that is through the provision of value); (2) to the time of payment—debt is created or extinguished dependent on the time at which ownership of a claim is established or relinquished; and (3) to whether the future payments required on existing liabilities are in the form of principal or interest.<sup>4</sup> As financial markets continue to innovate, this consistency of approach helps to ensure that the size and coverage of external debt is determined foremost by economic, and not payment, considerations.<sup>5</sup>

Finally, recording external debt on an accrual basis has the advantage of being consistent with other macroeconomic statistical systems, such as the *BPM6* and the *2008 SNA*, both of which employ an accrual basis of recording. These systems provide information on the types of economic flows during the reporting period that affect the size and composition of external debt. The Government Finance Statistics Manual (IMF, 2001) and the Monetary and Financial Statistics Manual (IMF, 2000d) are also on an accrual recording basis. Besides enhancing comparability of information across different sets of macroeconomic statistics for data users, the adoption of a common recording basis would also contribute to a reduction in compilation costs through the ability to use common data series in related statistical systems.

<sup>1</sup> This box draws on Efford (1996), which was prepared in the context of the development of the Government Finance Statistics Manual (IMF, 2001).

<sup>2</sup> In the 2008 SNA, economic flows in financial assets and liabilities are limited to those financial assets and liabilities for which economic value can be demonstrated or observed.

<sup>3</sup>On the basis of the descriptions above of the cash, due-for payment, and accrual reporting bases. For each reporting basis, there can be modifications of approach.

<sup>4</sup>In principle, under an accrual reporting basis, the external debt position at any one moment in time reflects past transactions and other economic flows, and, provided that the same valuation method is employed, equals the discounted value of future payments of interest and principal. For instance, if financial markets convert interest into principal, such as through stripped securities, the process of conversion has no impact on the measured external debt position because no new debt is created (although on a market value basis there could be valuation consequences arising from such a conversion).

<sup>5</sup>Although information on payment arrangements might well be valuable in its own right.

2.32. If debt payments are guaranteed by a third party, and the debtor defaults, once the guarantee is called, the debt liability is attributed to the guarantor, and the debt liability of the original debtor is extinguished. The original debtor often incurs a debt to the guarantor.<sup>17</sup>

#### Valuation

2.33. The *Guide* recommends that debt instruments are valued at the reference date at nominal value, and, for debt securities, at market value as well.<sup>18</sup> The nominal value of a debt instrument is a measure of value from the viewpoint of the debtor because at any moment in time it is the amount that the debtor owes to the creditor. This value is typically established by reference to the terms of a contract between the debtor and creditor, and it is frequently used to construct debt ratios, such as those described in Chapter 14. The market

<sup>&</sup>lt;sup>17</sup> Calling a guarantee may not imply that the debt liability of the original debtor is fully extinguished. There are guarantees that cover only the interest payments, but not the principal; so if the guarantee is called, the debt liability of the principal of the original debtor is not extinguished.

<sup>&</sup>lt;sup>18</sup> Valuation principles of financial assets and liabilities are discussed in detail in the *BPM6*, Chapter 3, and the *2008 SNA*, Chapter 13.

value of a debt security is determined by its prevailing market price, which, as the best indication of the value that economic agents currently attribute to specific financial claims, provides a measure of the opportunity cost to both the debtor and the creditor.<sup>19</sup> It is the valuation principle adopted in the *BPM6* and *2008 SNA*.

2.34. The *nominal value* of a debt instrument reflects the value of the debt at creation plus any subsequent economic flows, such as transactions (for example, repayment of principal); valuation changes (including exchange rate and other valuation changes other than market price changes); and any other changes. Conceptually, the nominal value of a debt instrument can be calculated by discounting future interest and principal payments at the existing contractual<sup>20</sup> interest rate(s)<sup>21</sup> on the instrument; these interest rates may be fixed rate or variable rate. For fixed- interest rate debt instruments and debt instruments with contractually predetermined interest rates, this principle is straightforward to apply because the future payment schedule and the rate(s) to apply are known,<sup>22</sup> but it is less straightforward to apply to debt instruments with variable interest rates that change with market conditions. The appendix at the end of this chapter provides examples of calculating the nominal value of a debt instrument by discounting future payments of interest and principal.

2.35. The *face value* of a debt instrument has been used to define nominal value in some instances, since the face value is the undiscounted amount of principal to be repaid. While of interest in showing amounts contractually due to be paid at a future date, the use of face value as nominal value in measuring the gross external debt position can result in an inconsistent approach across all instruments and is not recommended. For instance, the face value of deep-discount bonds and zero-coupon bonds includes interest costs that have not yet accrued, which is counter to the accrual principle.

2.36. The *market value* of a debt security should be determined by its market price prevailing on the reference date to which the position relates. The market price is defined as the amount of money that willing buyers pay to acquire something from willing sellers; the exchanges are made between independent parties and on the basis of commercial

<sup>&</sup>lt;sup>19</sup> In the HIPC Initiative (see Appendix V), a representative market rate is used to discount future payments. This provides another measure of opportunity cost and is specific to countries in that program.

<sup>&</sup>lt;sup>20</sup> Conceptually, the discount rate for debt instruments issued at a discount to the redemption value (such as deep-discount and zero-coupon bonds) should be that one at which the present value of future interest and principal payments equals the issue price of the bond; that is, the yield on the security at issuance (the original yield-to-maturity rate—see Appendix III) that is used to calculate the amount of accrued interest in each period—see the appendix at the end of this chapter.

<sup>&</sup>lt;sup>21</sup> A single rate is usually used to discount payments due in all future periods. In some circumstances, using different rates for the various future payments may be warranted. Even if a single rate of discount is used, dependent on the time until due, a different discount factor applies to each payment. For example, at a rate of discount of 10 percent, the discount factor for payments one year hence is 0.909 (or 1/(1 + 0.1)) and for payments two years hence is 0.826 (or 1/(1 + 0.1)2) and so on. See also the example in Table 2.1.

<sup>&</sup>lt;sup>22</sup> For a debt liability on which the interest rate steps up or down by contractually predetermined amounts over its life, the time profile of the discount factors to be applied to future payments would be nonlinear, reflecting these step changes.

considerations only, sometimes called "at arm's length." The ideal source of a market price for a debt security is an organized or other financial market in which it is traded in considerable volume and the market price is listed at regular intervals. In the absence of such a source, market value can be estimated by discounting future payment(s) at an appropriate market rate of interest. If the financial markets are closed on the reference date, the market price that should be used is that prevailing on the closest preceding date when the market was open. In some markets the market price quoted for debt securities does not take account of interest that have accrued but are not yet payable (the "clean price"), but in determining market value these interest costs need to be included (the "dirty price").

2.37. The *fair value* of a debt instrument is its "market-equivalent" value and is defined as the amount for which a financial asset could be exchanged, or a liability settled, between knowledgeable, wiling parties in an arm's-length transaction. It thus represents an estimate of what could be obtained if the creditor were to sell the financial claim.

#### Nonnegotiable debt instruments

2.38. The *Guide* recommends that debt instruments other than debt securities—such as loans, currency and deposits, and trade credits and advances—be valued at nominal value only.<sup>23</sup> The nominal value of a debt instrument could be less than originally advanced if there have been repayments of principal, debt forgiveness, or other economic flows, such as arising from indexation, that affect the value of the amount outstanding. The nominal value of a debt instrument could be more than originally advanced because, for example, of the accrual of interest costs, or other economic flows.

2.39. For debt instruments that accrue no interest— for example, liabilities arising because dividends on shares go ex-dividend—the nominal value is the amount owed. If there is an unusually long time<sup>24</sup> before payment is due on an outstanding debt liability on which no interest costs accrue, then the value of the principal should be reduced by an amount that reflects the time to maturity and an appropriate existing contractual rate, such as for similar debt instruments, and interest costs should accrue until actual payment is made.

2.40. For some debt instruments, such as loans, the use of nominal values is partially influenced by pragmatic concerns about data availability and the need to maintain symmetry between debtors and creditors. In addition, because loans are not intended for negotiability, without an active market, estimating a market price can be somewhat subjective. Nominal value is also analytically useful because it shows actual legal liability and the starting point

<sup>&</sup>lt;sup>23</sup> International statistical manuals consider that for nonnegotiable instruments, nominal value is an appropriate proxy for market value. Nonetheless, the development of markets, such as for credit derivatives linked to the credit risk of individual entities, is increasing the likelihood that market prices can be estimated even for nonnegotiable instruments. As these markets extend, consideration might be given to compiling additional information on market values of nonnegotiable debt. Where available and relevant, the fair value of loan assets should be shown as memorandum item.

<sup>&</sup>lt;sup>24</sup> What constitutes an unusually long time in this context will depend on the circumstances. For instance, for any given time period, the higher the level of interest rates, the greater is the opportunity cost of delayed payment.

of creditor recovery behavior. In some instances, loans may be traded, often at discount, or a fair value may exist or would be possible to estimate. Loans that have become negotiable de facto should be reclassified under debt securities.

2.41. Nonperforming loans are recorded at nominal value, which allows them to be compared with the total value of loans at nominal value (see Appendix III, *nonperforming loans*). The value should include accrued interest not yet paid. Loans continue to be included in nonperforming loans until written off, forgiven, reorganized, or they become performing loans. The three-month (or 90-day) criterion is the time period most widely used, although other periods are used. It is recognized that nominal value provides an incomplete view of the financial position, particularly when the loans are nonperforming. Therefore, if significant, separate identification of the nominal value of nonperforming loans is recommended.

2.42. Deposits, trade credits and advances, and other nonnegotiable instruments are recorded at nominal value. They give rise to the same issues of nominal and *fair values as loans*. Deposits at banks and other deposit-taking corporations in liquidation should be recorded at their nominal value until they are written off. If significant, separate identification of these deposits could be possible. The same treatment is applicable for any other cases of impaired deposits (i.e., where the deposit-taking corporation is not in liquidation but is insolvent).

2.43. For some debt instruments, such as a loan, repayment may be specified in a contract in terms of quantities of commodities, other goods, and/or services to be paid in installments over a period of time. At inception, the value of the debt is equal to the principal advanced. The rate of interest, which will accrue on the principal, is that which equates the present value of the required future provision of the commodity or other good, given its current market price, to the principal outstanding. Conceptually, this type of contract is equivalent to the indexation of a loan to a narrow index (see paragraph 2.95). When payments are made in the form of the good or commodity, the value of the principal outstanding will be reduced by the market value of the good or commodity at the time the payment is made.

2.44. In contrast, the value of the commodities, other goods, or services to be provided to extinguish a trade credit liability, including under barter arrangements, is that established at the creation of the debt; that is, when the exchange of value occurred. However, as noted above, if there is an unusually long time before payment, the value of the principal should be reduced by an amount that reflects the time to maturity and an appropriate existing contractual rate, and interest costs should accrue until actual payment is made.

2.45. The *Guide* recognizes the debt liabilities of insurance, pension funds, and standardized guarantee schemes to their nonresident participants and policyholders. These debt instruments are not traded on a market. They also do not always have a formula that can be applied to calculate a nominal value. However, the valuation principles that apply to these debt instruments are equivalent to market valuation. For life insurance, the debt liability is the value of the reserves held against the outstanding life insurance policies issued to nonresidents. The debt liability to nonresidents of nonlife insurance companies is the value of any prepayments of premiums by nonresidents, and the reserves for the outstanding

claims of nonresidents (both reported claims and claims incurred but not reported). The debt liability for a defined-benefit pension scheme is the present value of the promised benefits to nonresidents; while the debt liability for a defined-contribution scheme is the current market value of the fund's assets prorated for the share of nonresidents' claims vis-à-vis total claims.<sup>25</sup> The debt liabilities for standardized guarantee schemes is equal to the present value of expected calls under outstanding guarantees, net of any recoveries the guarantor expects to receive from the defaulting borrowers, a similar approach as for nonlife insurance. In general, insurance companies and operators of pension funds and standardized guarantee schemes make actuarial estimates of their liabilities under these schemes. These estimates will be the usual source to compile statistics for these debt instruments.

2.46. For arrears, the nominal value is equal to the value of the payments—interest and principal—missed, and any subsequent economic flows, such as the accrual of additional interest costs.

2.47. For nonnegotiable debt instruments where the nominal value is uncertain, the nominal value can be calculated by discounting future interest and principal payments at an appropriate existing contractual rate of interest.

### Traded debt instruments

2.48. The *Guide* recommends that debt securities be valued at both nominal and market value.<sup>26</sup> For a debt security, both nominal and market value can be determined from the value at creation and subsequent economic flows, except that market valuation takes account of any changes in the market price of the instrument, whereas nominal value does not.

2.49. For debt securities for which the market price is not readily observable, by using a market rate of interest the present value of the expected stream of future payments associated with the security can be used to estimate market value. This and other methods of estimating market value are explained in Box 2.2. For unlisted securities, the price reported for accounting or regulatory purposes might be used, although this method is less preferable than those mentioned above. Similarly, for deep-discount or zero-coupon bonds, the issue price plus amortization of the discount could be used in the absence of a market price.

#### Box 2.2. General Methods for Estimating Market Value

When market-price data are unavailable for negotiable instruments, there are two general methods for estimating market value or, as it is sometimes called, fair value:

- Discounting future cash flows to the present value using a market rate of interest; and
- Using market prices of financial assets and liabilities that are similar.

<sup>&</sup>lt;sup>25</sup> In a defined-benefit scheme, the level of pension benefits promised by the employer to participating employees is guaranteed and usually determined by a formula based on participants' length of service and salary. In a defined-contribution scheme, the level of contributions to the fund by the employer is guaranteed, but the benefits that will be paid depend on the assets of the fund.

<sup>&</sup>lt;sup>26</sup> This includes debt securities acquired under reverse transactions (see Table 4.5 in Chapter 4).

The first general method is to value financial assets and liabilities by basing market value on the present, or time-discounted, value of future cash flows. This is a well-established approach to valuation in both theory and practice. It calculates the market value of a financial asset or liability as the sum of the present values of all future cash flows. Market value is given by the following equation:

Discounted present value =  $\sum_{t=1}^{n}$ 

$$\frac{(\text{Cash flow})_t}{(1+i)^t}$$

where (Cash flow)<sub>t</sub> denotes the cash flow in a future period (t), n denotes the number of future periods for which cash flows are expected, and i denotes the interest rate that is applied to discount the future cash flow in period t.

The method is relatively easy to apply in valuing any financial asset or liability if the future cash flows are known with certainty or can be estimated, and if a market interest rate (or series of market interest rates) is observable.

Directly basing market value on the market price of a similar financial instrument is a well-used technique when a market price is not directly observable. For example, the market price of a bond with five-year remaining maturity might be given by the market price of a publicly traded five-year bond having comparable default risk. In other cases, it may be appropriate to use the market price of a similar financial instrument, but with some adjustment in the market value to account for differences in liquidity and/or risk level between the instruments.

In some cases, the financial asset or liability may possess some characteristics of each of several other financial instruments, even though its characteristics are not generally similar to any one of these instruments. In such cases, information on the market prices and other characteristics (for example, type of instrument, issuing sector, maturity, credit rating, etc.) of the traded instruments can be used in estimating the market value of the instrument.

2.50. If arrears are traded on secondary markets, as sometimes occurs, then a separate market value could be established.

2.51. When securities are quoted on markets with a buy-sell spread, the midpoint should be used to value the instrument. The spread is an implicit service of the dealer, paid by buyers and sellers.

#### Nondebt instruments

2.52. Liabilities positions in equity (both equity shares and other equity) and investment fund shares, and financial derivatives and ESOs, are not included in the gross external debt position because they are not debt liabilities, but they are recognized by the *Guide* as memorandum items to the external debt position. These instruments are to be valued at market value.

2.53. The market value of a forward financial derivatives contract is derived from the difference between the agreed-upon contract price of an underlying item and the prevailing market price (or market price expected to prevail) of that item, times the notional amount, appropriately discounted. The notional amount—sometimes described as the nominal

amount—is the amount underlying a financial derivatives contract that is necessary for calculating payments or receipts on the contract. This amount may or may not be exchanged. In the specific case of a swap contract, the market value is derived from the difference between the expected gross receipts and gross payments, appropriately discounted; that is, its net present value. The market value for a forward contract can therefore be calculated using available information—market and contract prices for the underlying item, time to maturity of the contract, the notional value, and market interest rates. From the viewpoint of the counterparties, the value of a forward contract may become negative (liability) or positive (asset) and may change both in magnitude and direction over time, depending on the movement in the market price for the underlying item. Forward contracts settled on a daily basis, such as those traded on organized exchanges—and known as futures—have a market value, but because of daily settlement it is likely to be zero value at each end-period.

2.54. The price of an option depends on the potential price volatility of the price of the underlying item, the time to maturity, interest rates, and the difference between the contract price and the market price of the underlying item. For traded options, whether they are traded on an exchange or not, the valuation should be based on the observable price. At inception the market value of a nontraded option is the amount of the premium paid or received. Subsequently nontraded options can be valued with the use of mathematical models, such as the Black-Scholes formulas, that take account of the factors mentioned above that determine option prices. In the absence of a pricing model, the price reported for accounting or regulatory purposes might be used. Unlike forwards, options cannot switch from negative to positive value, or vice versa, but they remain an asset for the owner and a liability for the writer of the option.

2.55. For equity shares that are listed in organized markets or are readily negotiable, the value of outstanding stocks should be based on market prices. The value of equity shares not quoted on stock exchanges or not traded regularly should be estimated by using prices of comparable quoted shares as regards past, current, and prospective attributes such as earnings and dividends. Alternatively, the net asset values of enterprises to which the equities relate could be used to estimate market values if the balance sheets of the enterprises are available on a current-value basis, but this is not a preferred method given the possibly large difference between balance sheet and equity market valuations.

2.56. For equity and investment fund shares (including reinvestment of earnings) related to direct investment, it is recognized that, in practice, balance sheet values of direct investment enterprises or direct investors are generally utilized to determine their value. If these balance sheet values are on a current market value basis, this valuation would be in accordance with the market value principle, but if these values are based on historical cost and not current revaluation, they would not conform to the principle. If historical cost from the balance sheets of direct investment enterprises (or investors) is used to determine the value of equity and investment fund shares (including reinvestment of earnings), compilers are also encouraged to collect data from enterprises on a current market value basis. Valuation according to the market-value equivalent is needed for valuing other equity (see footnote

below).<sup>27</sup> In instances where the shares of direct investment enterprises are listed on stock exchanges, the listed prices should be used to calculate the market value of shares in those enterprises.

#### Unit of Account and Exchange Rate Conversion

2.57. The compilation of the gross external debt position is complicated by the fact that the liabilities may be expressed initially in a variety of currencies or in other standards of value, such as SDRs. The conversion of these liabilities into a reference unit of account is a requisite for the construction of consistent and analytically meaningful gross external debt statistics.

2.58. From the perspective of the national compiler, the domestic currency is the obvious choice for measuring the gross external debt position. A position denominated in domestic currency is compatible with the national accounts and most of the economy's other economic and monetary statistics expressed in that unit. Data expressed in an international unit of account (a foreign currency) may be needed in circumstances of high inflation, multiple exchange rates and/or when the domestic currency is subject to significant exchange rate fluctuations. In addition, a standard or international unit of account is necessary to allow for aggregation on a global or regional basis and to facilitate international comparisons.<sup>28</sup>

2.59. The most appropriate exchange rate to be used for conversion of external debt liabilities (and assets) denominated in foreign currencies into the unit of account is the market (spot) rate prevailing on the reference date to which the position relates. The midpoint between buying and selling rates should be used. For conversion of debt in a multiple rate system,<sup>29</sup> the rate on the reference date for the actual exchange rate applicable to specific liabilities (and assets) should be used.

### Maturity

2.60. For debt liabilities, it is recommended that the traditional distinction between longand short-term maturity, based on the formal criterion of original maturity (that is the period of time from when the liability is created to its final maturity date) be retained. Long-term debt is defined as debt with an original maturity of more than one year or with no stated maturity. Short-term debt, which includes currency, is defined as debt repayable on demand or with an original maturity of one year or less. If an instrument has an original maturity of one year or less it should be classified as short-term, even if the instrument is issued under an arrangement that is long-term in nature. For instance, a note issued under a note issuance facilities (NIFs) or a revolving underwriting facilities (RUFs) is a short-term instrument

<sup>&</sup>lt;sup>27</sup> See *BPM6*, paragraphs 7.15-7.19, for a detailed description of alternative methods of approximating market value of shareholders' equity in a direct investment enterprise.

<sup>&</sup>lt;sup>28</sup> For instance the Quarterly External Debt Statistics (QEDS) database and the Joint External Debt Hub (JEDH) are compiled and disseminated in US dollars. See Chapter 16 for information on these databases.

<sup>&</sup>lt;sup>29</sup> A multiple exchange rate system is a scheme for which there are schedules of exchange rates, set by the authorities, used to apply separate exchange rates to various categories of transactions or transactors.

issued under a legally binding medium-term facility—a form of revolving credit (see Appendix I)..

2.61. In addition, the distinction between long and short term maturity on a remaining maturity basis is recommended. External debt on a short-term remaining maturity basis covers debt payments that fall due in one year or less, and can be calculated by adding the value of outstanding short-term external debt (original maturity) to the value of outstanding long-term external debt (original maturity) due to be paid in one year or less. External debt on a long-term remaining maturity basis covers debt payments that fall due in over one year. This measure of maturity is discussed in more detail in Chapter 6.

## Appendix: Accrual of Interest Costs—How Should This Be Implemented?

2.62. The *Guide* recommends including interest costs that have accrued and are not yet payable in the gross external debt position. This annex presents the theoretical framework for the accrual of interest costs, and a more detailed discussion on how to apply the accrual principle, by type of instrument.

2.63. Because the focus of the *Guide* is on position statistics, the debate about whether the rate at which interest should accrue on market-traded instruments should be based on the current market value of the debt (the so-called creditor approach) or as stipulated in the original contract (the so-called debtor approach) is not relevant.<sup>30</sup> This is because the market value position to be reported is based on the market price of the instrument, and that value should include any interest costs that have accrued and are not yet payable. Given this, unless otherwise stated, this annex focuses on nominal value.

2.64. At the outset, it is worth noting some key principles for applying the accrual of interest costs principle in both the nominal and market value presentations of external debt:

- All financial instruments bearing interest are included;
- The accrual of interest costs can be calculated by the straightline or compound interest method;
- All instruments issued at a discount are treated in a similar manner; and
- The accrual of interest costs also applies to variable-rate and index-linked instruments.

 $<sup>^{30}</sup>$  For additional information about the creditor/debtor approaches for defining and measuring interest rate for traded debt instruments see *BPM6*, paragraph 11.52. In the international accounts, interest is recorded following the debtor approach.

#### **Theoretical Framework for the Accrual of Interest Costs**

2.65. Three examples, drawn from work undertaken by Statistics Canada (see Laliberté and Tremblay, 1996), are provided to illustrate the theoretical framework for the accrual of interest costs. These examples, and the discussion on accruing interest costs on a straight line or compound basis that immediately follows, provide an explanation of the basic principles.

2.66. The first example is that of a simple instrument that is issued and redeemed at the same price<sup>31</sup> and pays fixed annual interest at the end of each year; the second example is of an instrument issued at a price that is at a discount to the redemption price, and that also makes annual interest payments; and the third example is of an instrument issued at a discount that has no interest payments. These examples have general applicability throughout the *Guide*, in that they explain how future payments can be discounted to produce the external debt position at any moment in time.

#### Example 1: Present Value and the Accrual of Interest Costs—Simple Case

2.67. In this simple example, a debt instrument is issued with a five-year maturity, a principal amount of \$100, and annual payments of \$10 each year as interest. That is, the interest rate on the instrument is fixed at 10 percent a year. Given this, as seen in Table 2.1, in present value terms the payment of \$10 in a year's time is worth 10/(1+0.1), or 9.09; the payment of \$10 in two years' time is worth 10/(1+0.1)2, or 8.26; and so on. In present value terms, the principal amount advanced to be repaid at maturity is worth 100/(1+0.1)5, or 62.09. The present value for each payment is provided in the left-hand column, and it can be seen that the present value of all future payments equals the issue price of \$100.

2.68. Because interest costs accrue at 10 percent a year on a continuous basis, and are added to the principal amount, after six months of the first year the principal amount has increased. It equals the \$100 principal amount due to be paid at maturity, plus half of the year's interest payment, \$5 (calculated on a straightline basis), or plus just under half, \$4.88 (calculated on a compound basis). Any payments of interest, or principal, would reduce the amount outstanding.

2.69. Alternatively, the principal amount outstanding after six months could be calculated by discounting all future payments. The present value of each payment after six months is presented in parentheses in the left-hand column. After six months, each of the values in the left-hand column has increased because the payments are closer to being made, and time is being discounted at a rate of 10 percent a year. The discounted value of each payment after six months can be seen to sum to \$104.88, the same amount outstanding as with the compound approach to accruing interest costs. One practical advantage of maintaining a system that discounts each payment to its present value is that if the instrument is stripped (see below)— that is, all payments traded separately—the compilation system will already be prepared for such a situation.

<sup>&</sup>lt;sup>31</sup> If an economy was disseminating a debt-service ratio with future interest and principal payments calculated using the current yield on debt, then if the market value of external debt rises, part of the future interest payments could become principal payments.

Prese in	nt Value 2001	2002	2003	2004	2005	2006
9.09	(9.54)*	10/(1+0.1)				
8.26	(8.66)		10/(1+0.1)2			
7.52	(7.89)			0/(   +0.   ) <sup>3</sup>		
6.83	(7.16)				10/(1+0.1)4	
6.21	(6.51)					10/(1+0.
37.91	(39.76)	10/(1+0.1)	$ 0/(1+0.1)^2$	$10/(1+0.1)^3$	10/(1+0.1)4	10/(1+0.
62.09	(65.12)	· · /	· · · /	· · /	· /	100/(1+0.
00.00	(104.99)					·

Table 2.1	Present Value and	the Accrual of	Interest Co	ets Example	1.7	Simple	Case	١.
Table 2.1.	Fresenc value and	ule Accrual of	muerest Cu	ists: Example		Simple	Case,	

2.70. Unless there are early repayments that reduce the amount of principal outstanding for instance, with certain types of asset-backed securities, partial repayments of principal could occur at any time— the amounts described above would be recorded in the gross external debt position; that is, after six months with a contractual interest rate of ten percent per annum, the amount outstanding would be \$104.88 (or \$105 on a straightline basis).

2.71. The rate relevant for discounting all the payments to a market value would be implicit in the market price, or to put it another way, the market value amount would equal future payments discounted at the current market rate of interest for that debt instrument. The market value of external debt should include any interest costs that have accrued and are not yet payable.

#### **Example 2: Present Value and the Accrual of Interest Costs—Discounted Principal**

2.72. The second example concerns the more complex case of instruments issued at a discount to the redemption value. These instruments will include securities, and any other instruments where the issue price is less than the redemption price.<sup>32</sup> In this instance, both the coupon payments and the difference between the issue price and the redemption price determine the rate at which interest costs accrue. Table 2.2 presents the calculations involving an instrument similar to that in the first example above—that is, issued with the same 10 percent yield, but "only" having annual interest payments of \$8. The difference between the 10 percent yield and the yield implied by coupon payments is reflected in the discount between the issue price and redemption price. Once again, from the left-hand column of the table it can be seen that discounting all the future payments by 10 percent, including the principal amount, provides the issue price of \$92.40.

<sup>&</sup>lt;sup>32</sup> For instruments issued at a discount, issue price is a generic term that means the value of principal at inception of the debt; redemption price is similarly a generic term that means the amount of principal to be paid at maturity. This is because some instruments are "issued" without a price as such (for instance, trade credit). In such instances, the issue price equals the economic value provided (that is, of goods or services provided) and the redemption price equals the amount owed when the debt liability is due to be paid.

2.73. How is the accrual of interest costs calculated? Simply, interest costs accrue at a yield of 10 percent each year, of which \$8 is paid out in interest payments and the rest is reinvested (or capitalized) into the original principal amount. The principal amount grows from year to year, due to the continued reinvestment of interest costs that have accrued, and as a consequence, so does the absolute amount of interest costs that accrue each year. As with the first example, the present value of each payment after six months is presented in parentheses in the left-hand column. In the position data, the amount outstanding can be seen to be \$96.91 after six months.

Presen 2	t value in 001	2002	2003	2004	2005	2006
7.27	(7.62)*	8/(1+0.1)				
6.61	(6.93)	. ,	8/(1+0.1)2			
6.01	(6.30)		. ,	8/(1+0.1)3		
5.46	(5.73)				8/(1+0.1)4	
4.97	(5.21)					8/(1+0.
30.31	(31.79)	8/(1+0.1)	$\frac{1}{8/(1+0.1)^2}$	8/(1+0.1)3	8/(1+0.1)4	8/(1+0.
62.09	(65.12)	· · /	· · /	· · /	· · /	100/(1+0.
92.40	(96.91)					

#### Example 3: Present Value and the Accrual of Interest—Zero-Coupon Instrument

2.74. The third example covers zero-coupon instruments. If the instrument is issued at discount and has no coupon, then the principal amount increases in value over time by the implicit yield on the security at issuance, derived from the difference between the issue price and the redemption price. In the example below, the zero-coupon instrument is issued at \$62.09 and is to be redeemed at \$100; the difference implies a 10 percent yield. As can be seen in Table 2.3, the principal amount grows each year because of the continued reinvestment of interest costs that accrue, and so after the first year the amount outstanding has increased by 10 percent to \$68.30, by a further 10 percent in year two to \$75.13, and so on until redemption at \$100 at the end of year five.<sup>33</sup>

#### Straightline or compound interest

2.75. In calculating the accrual of interest costs by a straightline approach, an equal amount of the interest costs to be paid is attributed to each period—for example, \$5 for the first six months in the first example above. For bonds with interest payments (that is, annual or more frequent), on secondary markets the buyer of the bond pays to the seller the amount accrued since the last payment, according to a very simple arithmetic proportionality. For many international loans, debt-monitoring systems record the accrual of interest costs on a straightline basis.

<sup>&</sup>lt;sup>33</sup> A worked example of accruing interest on a zero-coupon bond in the balance of payments is given in the IMF's *Balance of Payments Textbook* (1996), paragraphs 400 and 401, page 83.

2.76. However, the accrual of interest costs can also be calculated on a compound basis that is, continuously adding the accrued interest costs not yet payable to the principal amount each period, and applying to that amount the interest yield on the debt in order to calculate the interest costs for the next period. This method is the theoretically preferred approach because it relates the cost to the provision of capital and allows reconciliation between amounts accrued and the discounted value of future payments. Such an approach is commonly used when information on individual instruments owned by nonresidents is unknown, and so to calculate the accrual of interest costs an average yield is applied to positions. Of course, in such instances the theoretical benefit of using a yield is offset by the approximation of applying an average yield to a range of instruments.

2.77. Differences in methods may well have a small effect on the gross external debt position. However, as is evident from the first example, for each instrument the straightline approach will overestimate the position in the short term. For fixed-rate instruments, this will be gradually "unwound" as the time of the interest payment approaches.

Present Value in 2001	2002	2003	2004	2005	2006
100/(1 + 0.1)	62.09 (1 + 0.1)	62.09 (1 + 0.1) <sup>2</sup>	62.09 (1 + 0.1) <sup>3</sup>	62.09 (1 + 0.1) <sup>4</sup>	62.09 (1 + 0.1) <sup>5</sup>
= 62.09	= 68.30	= 75.13	= 82.64	= 90.90	= 100

## Specific Instruments<sup>34</sup>

#### Fixed-rate instruments

#### Loans

2.78. For loans (except interest-free loans) interest costs are recorded as accruing continuously, increasing the value of the loan outstanding, until paid. When loans have been rescheduled and a new (moratorium) interest rate agreed between the debtor and creditor, interest costs should accrue on the rescheduled debt at the new moratorium interest rate.

#### Deposits

2.79. For deposits, interest may be credited to the account (reinvested) at certain times, such as the end of a given period. In the *Guide*, interest costs accrue continuously and become part of principal on a continuous basis.

<sup>&</sup>lt;sup>34</sup> This text has drawn upon that in Eurostat (2000), the *ESA95 Manual on Government Deficit and Debt*, and *BPM6*.

2.80. For some deposits, such as time or savings deposits, a given rate of interest may be paid only under the condition of a minimum holding period. An early liquidation, if contractually allowed, is balanced by a reduction in the rate of interest paid to the holder. For recording the accrual of interest costs, the rate of interest to use is the maximum rate that the depositor could receive in the normal course of the contract (that is, respecting the arrangements about maturity or notice). In the event, if the arrangements are not fully respected, the amount of interest costs that accrued previously are corrected in line with the rate the depositor actually received. As the revised amount is in all likelihood globally very small compared with the total interest costs for deposits, for practical reasons the correction could be included in the last period of compilation (as opposed to revising back data).

#### Debt securities

2.81. For securities for which the issue and redemption prices are the same, interest costs accrue in the same manner as for loans, on a yield-to-maturity basis.

#### Instruments issued at a discount

2.82. Instruments for which the issue price is less than the redemption price are all treated in the same way. This includes nonnegotiable instruments where the amount to be paid is greater than the economic value provided at inception of the debt. The method of accrual for instruments issued at a discount or premium was described in paragraph 2.30 above and includes accruing any difference between the redemption price and the issue price as interest over the lifetime of the security (see also the examples in paragraphs 2.72 and 2.74).

2.83. For short-term negotiable instruments<sup>,35</sup> issuance at a discount is very frequent. Generally these instruments are akin to zero-coupon bonds (example 3 above), and so the treatment of such instruments is the same. Without information on individual securities, one practical approach is to base estimates of the accrual of interest costs on average maturities and average rates of interest at issuance.

2.84. External debt, particularly general government debt, could be issued in the form of fungible bonds (also named linear bonds). In this case, securities are issued under one similar "line" (in terms of coupon amounts and payment dates, and final redemption price and maturity date) in tranches, generally issued during a rather short period but sometimes over a longer one. Each tranche is issued at a specific issue price according to the prevailing market conditions. Fungible bonds may be seen as a good example of instruments with two interest components: the coupon (representing the interest payment), and the difference between the issue price and redemption price. Thus, in principle each tranche should be identified separately because the nominal interest rate might well differ from tranche to tranche given the different market conditions that existed when they were issued. Once issued, however, the tranches may mix and so may not trade separately on secondary markets, nor be identified separately in portfolios. If so, it is necessary to estimate a

<sup>&</sup>lt;sup>35</sup> A negotiable financial instrument is one whose legal ownership is capable of being transferred from one unit to another unit by delivery or endorsement.

weighted-average interest rate resulting from issuing different tranches, updated at each new issue, and apply this to the amount owed to nonresidents.<sup>36</sup>

#### Stripped securities

2.85. Stripped securities are securities that have been transformed from a principal amount with interest payments into a series of zero-coupon bonds, with a range of maturities matching the interest payment dates and the redemption date of the principal amount. The essence of stripping was described in the first example above: the coupon payment amounts are separately traded. In itself, the act of stripping does not affect the nominal value of the debt outstanding for the issuer of the securities that have been stripped.

2.86. There are two types of stripping. First, if the stripped securities are issued by a third party, who has acquired the original securities and is using them to "back" the issue of the stripped securities, then new funds have been raised by the third party, with the interest rate determined at the time of issuance.

2.87. On the other hand, if the owner of the original security has asked the settlement house or clearing house in which the security is registered to "issue" strips from the original security, the strips replace the original security and remain the direct obligation of the issuer of the original security. In the gross external debt position on a nominal value basis, it is unrealistic from a practical point of view to take into account the rate prevailing at the issuance of each strip. Rather, since stripping provides no additional funding to the issuer and there is no impact on the original cost of borrowing, fully determined at the issuance time (in the case of fixed-rate) or following rules that cannot be changed (in the case of variable-rate), it is assumed that stripping does not change the cost of borrowing. So, unlike other zero-coupon bonds, the interest rate used for calculating the accrual of interest costs for strips is not the rate prevailing at the time of stripping, but rather the original cost of borrowing—that is, on the underlying security.

2.88. In some countries, strips of interest payments may refer to coupons of several bonds, with different nominal amounts but paid at the same date. In this case, best efforts should be made to use the weighted-average nominal interest rate of the different underlying bonds to calculate the accrual of interest costs on the stripped securities.

#### Arrears

2.89. Interest costs that accrue on arrears (both principal and interest arrears) are known as late interest. For arrears arising from a debt contract, interest costs should accrue at the same interest rate as on the original debt, unless the interest rate for arrears was stipulated in the original debt contract, in which case this stipulated interest rate should be used. The stipulated rate may include a penalty rate in addition to the interest rate on the original debt. For other arrears, in the absence of other information, interest costs accrue on these arrears at the market rate of interest for overnight borrowing. Also, any additional charges relating to

<sup>&</sup>lt;sup>36</sup> A creditor might focus on the prevailing market interest rate, or the rate prevailing when they purchased the security, and hence might record the claim at a value different from that recorded by the debtor.

past arrears, agreed by the debtor and creditor at the time the arrears are rescheduled, and to be paid by the debtor to the creditor, should be regarded as an interest cost of the debtor at the time the agreement is implemented. If an item is purchased on credit and the debtor fails to pay within the period stated at the time the purchase was made, any extra charges incurred should be regarded as an interest cost and accrue until the debt is extinguished.

#### Variable-rate instruments

#### Interest-rate-linked instruments

2.90. For loans, deposits, and securities, the same principles as with fixed-rate instruments apply, except that in the absence of firm information, the accrual of interest costs should be estimated and added to the gross external debt position, using the most recent relevant observation(s) of the reference index. Revisions to back data should be undertaken when the amount of interest costs that have accrued is known with certainty.

2.91. In addition, if the interest rate can vary only under the condition of a minimum change in the index and/or within specific upward limits, any estimate of the accrual of interest costs should take account of any such conditions. If there is a link between the nature of the rate index and the frequency of interest payments—for example, interest is indexed on a quarterly basis and is normally paid every quarter with a delay of one quarter—then the exact amount paid to the owners of the securities may well be known in advance, and so can be accrued with certainty. This is known as interest being "predetermined."

#### Index-linked instruments

2.92. External debt might be indexed to indices other than interest rate indices. Examples include indexing to the price of a commodity, an exchange rate index, a stock exchange index, or the price of a specific security, and so on. Principal as well as interest payments may be indexed. The index can apply continuously over all or part of the life of the instrument. Any change in value related to indexation of interest is recorded as an interest cost, and so affects the principal amount outstanding until paid. The impact of the indexation of the principal amount is recorded as increasing (or decreasing) the principal amount on a continuous basis for the period during which the indexing is operative. The indexation of principal may be recorded as the accrual of interest or a holding gain or loss depending on the nature of the index (narrow or broad based).<sup>37</sup>

2.93. The method of calculation is the same as that for variable-rate interest discussed above; that is, the accrued amount should be estimated using the most recent relevant observation(s) of the reference index and added to the gross external debt position. For instance, if in the first example above interest payments were indexed, and movement in the index after six months suggested that interest payments would increase to \$12 a year, then the interest costs accrued to date would be \$6 on a straight-line basis (or \$5.80 on a compound basis), and the amount outstanding \$106 (\$105.80). Revisions to back data are undertaken when the amount of interest costs that have accrued is known with certainty.

<sup>&</sup>lt;sup>37</sup> See *BPM6*, paragraphs 11.59-11.65 for a detailed description of these two approaches.

2.94. In contrast, positions in debt instruments with both the amount to be paid at maturity and interest payments indexed to foreign currency, should be calculated using the same principles that apply to foreign-currency-denominated instruments, because they are treated as though they are denominated in that foreign currency.

2.95. As mentioned above, a loan that is repayable in commodities or other goods in installments over a period of time (see paragraph 2.43) is conceptually equivalent to an indexed loan. At inception, the principal amount outstanding is the value of principal advanced; as with other debt instruments indexed to a narrow index, interest costs will accrue on this amount equal to the interest rate that equates the market value of the commodities or other goods to be paid with the principal amount outstanding at inception. As the market price of the commodity or other good changes, so will the valuation of the principal amount, the same as shown in the example for narrow index instrument, subject to any payments made by the debtor in the form of commodities or goods (or cash). So, an index of the underlying commodity, such as oil, will need to be used to estimate the value of the position from end-period.

2.96. Index-linked instruments may include a clause for a minimum guaranteed redemption value. Any estimate of the accrual of interest costs should take account of such conditions. For instance, if strict application of the index had the effect of reducing the amount outstanding to less than the minimum, it would not be relevant to record any reduction below the minimum guaranteed redemption value. Normally, the current market price of debt instruments takes into account such a clause.

#### Instruments with grace periods of interest

2.97. Some debt instruments may have a grace period during which no interest payments are to be made. For those debt instruments for which the contract requires the accrual of interest during the grace period (that is, the relevant interest rate that applies to the grace period is greater than zero), the accrual of interest should be recorded as specified in the contract, increasing the value of the principal. On the other hand, if the debtor can repay the same amount of principal at the end of the grace period as at the beginning (that is, the relevant interest rate that applies to the grace period is zero), no interest costs accrue during the grace period.<sup>38</sup> This remains true even if the rate of interest applied in a second and/or subsequent time period is adjusted (for example, there is a step up), so that the final yield is roughly similar to normal conditions over the total life of the instrument. This treatment applies to loans and deposits but not to debt securities. Box 2.3 presents examples of the recording of accrued interest on different types of loans, including loans with a single fixed interest rate, loans with step-up interest rates, loans with step-up interest rates where a zero interest rate applies to the first two steps, and loans that accrue interest but the payments are contractually deferred.

2.98. Loans with step-up interest should accrue at the contractual rate of interest for any period and not at the internal rate of return of the loan. On the other hand, interest on debt

 $<sup>^{38}</sup>$  If a prepayment fee or penalty is paid, it should be classified as a service fee (not interest) consistent with *BPM6*, paragraph 10.120.

securities with step-up interest should accrue at the original yield-to-maturity rate over the life of the security.<sup>39</sup> Box 2.4 presents examples of the recording of accrued interest on different types of debt securities, including debt securities with a fixed coupon, debt securities with step-up coupons, and debt securities with step-up coupons where the first two coupons are zero.

<sup>&</sup>lt;sup>39</sup> The original yield-to-maturity rate is the rate at which the present value of future interest and principal payments equals the issue price of the bond; that is, the yield of the security at issuance.

#### **Box 2.3 Recording of Accrued Interest Costs on Loans**

Table 1 shows four loan examples with a maturity of 5 years, a principal amount of 100 to be repaid at maturity, and an internal rate of return of 5%. The loans differ on the interest rates contractually agreed for each year; interest accrued during a year is to be paid at the end of that year.

Example 1 shows a loan with a fixed interest rate and example 2 a loan with a step-up interest rate. Example 3 is a variant on example 2 in that a zero interest rate applies to the first two steps of the loan (the loan contract in this example would specify that if the loan would be redeemed during the period when the zero interest rate applies, only the principal has to be reimbursed). Example 4 is different as interest costs accrued in the first two years are paid in year 3 together with the interest costs accrued during year 3. In case of an early redemption in the first two years, not only the principal but also the interest costs accrued but not yet paid would have to be redeemed.

	Example 1 Fixed interest rate	Example 2 Step-up interest rate	Example 3 Step-up interest rate with no interest charged in the first two years	Example 4 Fixed interest rate with interest of the first two years paid in the third year
Maturity (years)	5	5	5	5
Principal	100	100	100	100
Interest rate: Year 1	5.0%	0.5%	0% (no interest accrued)	5% (paid in year 3)
Year 2	5.0%	2.0%	0% (no interest accrued)	5% (paid in year 3)
Year 3	5.0%	6.0%	6.1%	5.0%
Year 4	5.0%	7.7%	8.5%	5.0%
Year 5	5.0%	10.0%	12.0%	5.0%
Internal rate of return (IRR)	5.0%	5.0%	5.0%	5.0%

#### **Table 1 – Loan examples**

The statistical recordings provided below are shown from the debtor perspective.

#### **Example 1: fixed interest rate**

This is one of the most common types of loan contracts. In the first year (at the beginning of the year) the principal amount is disbursed to the debtor and recorded as a loan liability. In the same period, interest costs accrue at a rate of 5%, and are recorded as interest payable transactions with the corresponding increase of the outstanding debt (accrued interest costs). The accrued interest costs are paid at the end of the year, therefore the outstanding debt decreases accordingly. At the end of the first year, the loan position shows the same value as the principal amount (100). For the other years the same logic applies. At maturity the principal amount is repaid together with the interest costs accrued in that year.

			_			
Year	Cash flows (1)=(3)+(5)	Total (2)=(3)+(4)+(5)	Principal (3)	Interest Costs Accrued (4)	Interest Costs Paid (5)	Loan Liabilities at end-year (6)
1	+95.00	+100.00	+100.00	+5.00	-5.00	+100.00
2	-5.00	0.00	0.00	+5.00	-5.00	+100.00
3	-5.00	0.00	0.00	+5.00	-5.00	+100.00
4	-5.00	0.00	0.00	+5.00	-5.00	+100.00
5	-105.00	-100.00	-100.00	+5.00	-5.00	0.00

#### **Example 2: step-up interest rate**

The case of step-up interest rates implies a recording of different interest costs amounts. However, the same mechanism as in example 1 applies.

			Leen			
Year	Cash flows (1)=(3)+(5)	Total (2)=(3)+(4)+(5)	Principal (3)	Interest Costs Accrued (4)	Interest Costs Paid (5)	Liabilities at end-year (6)
1	+99.50	+100.00	+100.00	+0.50	-0.50	+100.00
2	-2.00	0.00	0.00	+2.00	-2.00	+100.00
3	-6.00	0.00	0.00	+6.00	-6.00	+100.00
4	-7.70	0.00	0.00	+7.70	-7.70	+100.00
5	-110.00	-100.00	-100.00	+10.00	-10.00	0.00

#### Example 3: step-up interest rate (with one or more of the steps being zero)

This case shows a loan with step-up interest rates and with a zero interest rate in the first two years. The recording is similar to example 2; however, during the first two years the accrued interest costs amount to zero as a consequence of the zero interest rate.

			Loon			
Year	Cash flows (1)=(3)+(5)	Total (2)=(3)+(4)+(5)	Principal (3)	Interest Costs Accrued (4)	Interest Costs Paid (5)	Liabilities at end-year (6)
1	+100.00	+100.00	+100.00	0.00	0.00	+100.00
2	0.00	0.00	0.00	0.00	0.00	+100.00
3	-6.10	0.00	0.00	+6.10	-6.10	+100.00
4	-8.50	0.00	0.00	+8.50	-8.50	+100.00
5	-112.00	-100.00	-100.00	+12.00	-12.00	0.00

#### Example 4: postponement of the payment of accrued interest costs

The last example shows a loan on which the accrued interest costs in the first two years are paid together with the interest costs accrued in the third year, i.e. the payment of interest costs are deferred. Accrued interest costs are recorded each year and added to the outstanding debt to be repaid, that is, accrued interest costs not paid in the first two years increase the loan position at end-year. Since accrued interest costs are calculated on the increasing (outstanding) debt, the interest costs accrued in year 2 and year 3 are higher than in year 1. In the third year the cumulated accrued interest costs are fully paid and the outstanding debt returns to its principal value of 100. The remaining years are recorded similarly to example 1.

			Loon			
Year	Cash flows (1)=(3)+(5)	Total (2)=(3)+(4)+(5)	Principal (3)	Interest Costs Accrued (4)	Interest Costs Paid (5)	Liabilities at end-year (6)
1	+100.00	+105.00	+100.00	+5.00	0.00	+105.00
2	0.00	+5.25	0.00	+5.25	0.00	+110.25
3	-15.76	-10.25	0.00	+5.51	-15.76	+100.00
4	-5.00	0.00	0.00	+5.00	-5.00	+100.00
5	-105.00	-100.00	-100.00	+5.00	-5.00	0.00
#### **Box 2.4 Recording of Accrued Interest Costs on Debt Securities**

Table 1 shows three examples of debt securities with a maturity of 5 years, a principal amount of 100 to be repaid at maturity and a yield-to-maturity at inception of 5%. The securities differ on the coupon paid at the end of each period. Example 1 shows a debt security with a fixed coupon, example 2 a debt security with a step-up coupon, and example 3 is a variation on example 2 in that the first two coupons are zero.

## **Table 1 – Debt securities examples**

	Example 1 Fixed coupon	Example 2 Step-up coupon	Example 3 Step-up coupon with zero coupon in the first two years
Maturity (years)	5	5	5
Principal	100	100	100
Interest rate: Year 1	5.0%	0.5%	0.0%
Year 2	5.0%	2.0%	0.0%
Year 3	5.0%	6.0%	6.1%
Year 4	5.0%	7.7%	8.5%
Year 5	5.0%	10.0%	12.0%
Original yield-to-maturity	5.0%	5.0%	5.0%

The statistical recordings provided below are shown from the debtor perspective (and interest is recorded following the debtor approach).

#### Example 1: fixed coupon

In the first year (at the beginning of the year) the debt security is issued at par value and recorded as a debt security liability. In the same period, interest costs accrue at the original yield-to-maturity of 5%, and are recorded as interest payable transactions with the corresponding increase of the outstanding debt (accrued interest costs). The accrued interest costs (equal to the coupon in this example) are paid at the end of the year, therefore the outstanding debt decreases accordingly. At the end of the first year, the debt security position shows the same value as the principal amount (100). For the other years the same logic applies. At maturity, the principal amount is repaid together with the interest costs accrued in that year.

		Debt	Debt Security Liabilities Transactions			Debt
Year	Cash flows (1)=(3)+(5)	Total (2)=(3)+(4)+(5)	Principal (3)	Interest Costs Accrued* (4)	Coupon Paid (5)	Security Liabilities at end-year (6)
1	+95.0	+100.0	+100.0	+5.00	-5.00	+100.0
2	-5.0	0.0	0.0	+5.00	-5.00	+100.0
3	-5.0	0.0	0.0	+5.00	-5.00	+100.0
4	-5.0	0.0	0.0	+5.00	-5.00	+100.0
5	-105.0	-100.0	-100.0	+5.00	-5.00	0.0

#### Example 2: step-up coupon

The case of step-up coupon implies a recording of different interest costs amounts. However, the same mechanism as in example 1 applies. Interest costs accrue at the original yield-to-maturity of 5%, and are recorded as interest payable transactions with the corresponding increase of the outstanding debt (accrued interest costs). Coupons (which in this example are different from the accrued interest costs) are paid at the end of the year, therefore the outstanding debt decreases accordingly. In summary, in each period, the difference between the accrued interest costs and the coupon paid is reinvested (or capitalized) into the

		Debt	Debt Security Liabilities Transactions			Debt
		Total	Principal	Interest Costs	Coupon Paid	Security Liabilities at
Year	Cash flows	(2)=(3)+(4)+(5)	(3)	Accrued*	(5)	end-year
	(1)=(3)+(5)			(4)		(6)
1	+99.5	+104.5	+100.0	+5.0	-0.5	+104.5
2	-2.0	+3.2	0.0	+5.2	-2.0	+107.7
3	-6.0	-0.6	0.0	+5.4	-6.0	+107.1
4	-7.7	-2.3	0.0	+5.4	-7.7	+104.8
5	-110.0	-104.8	-100.0	+5.2	-10.0	0.0

principal amount, with the corresponding change in the outstanding debt.

#### Example 3: step-up coupon (with zero coupon in the first two years)

This case shows a debt security with step-up coupon and with zero coupon in the first two years. The recording of accrued interest costs uses the same principles as example 2.

		Debt	Debt Security Liabilities Transactions			Debt
Year	Cash flows (1)=(3)+(5)	Total (2)=(3)+(4)+(5)	Principal (3)	Interest Costs Accrued* (4)	Coupon Paid (5)	Securities Liabilities at end-year (6)
1	+100.0	+105.00	+100.0	+5.0	0.0	+105.0
2	0.0	+5.3	0.0	+5.3	0.0	+110.3
3	-6.1	-0.6	0.0	+5.5	-6.1	+109.7
4	-8.5	-3.0	0.0	+5.5	-8.5	+106.6
5	-112.0	-106.7	-100.0	+5.3	-12.0	0.0

In these three examples, it is assumed that there are no changes in the market interest rate during the lifetime of the security; therefore, the outstanding debt position at end-year (column 6 in the tables) reflects both the nominal and the market value of the security. Changes in market interest rates will lead to changes in the market value of the security, which will be different from the nominal value recorded in these examples. Nevertheless, the recording of interest costs will be the same as in the examples.

\* Accrued interest costs (4) are calculated by applying the original yield-to-maturity rate (5%) to the outstanding debt at the end of the previous year (6).

#### Instruments with embedded derivatives

2.99. Some instruments may have embedded derivatives that could, if exercised, affect the rate of interest. For such instruments, interest costs should accrue, and be included in the gross external debt position, as "normal." If the financial derivative is exercised and so affects the interest rate, this should be reflected in the rate at which interest accrues—for example, in a structured note with a maximum interest rate, when, and as long as, the maximum is reached and so the financial derivative is "exercised," interest costs should accrue at the maximum rate and no more. The market price of debt instruments should reflect the likelihood of the financial derivative being exercised.

#### Foreign currency instruments

2.100. Interest costs should accrue (or not) in foreign currency on an instrument denominated in foreign currency, adding to the outstanding principal amount, until paid. The

principal amount in foreign currency should be converted into the unit of account at the midpoint between the buying and selling market (spot) rates on the reference date to which the position relates.

# 3. IDENTIFICATION OF INSTITUTIONAL SECTORS AND FINANCIAL INSTRUMENTS

## A. Introduction

3.1 In the *Guide*, as in the 2008 SNA and BPM6, institutional units, and the instruments in which they transact, are grouped into categories so as to enhance the analytical usefulness of the data. Institutional units are grouped into institutional sectors, and financial instruments are classified by their nature into instrument categories. However, the classifications of institutional sectors and financial instruments are determined by the analytical needs of external debt statistics and so can differ from other macroeconomic datasets.

3.2 The institutional sector breakdown groups institutional units with common economic objectives and functions: *general government, central bank, deposit-taking corporations except the central bank*, and *other sectors*. These sectors are defined in this chapter, as are the subsectors of *other sectors*: other financial corporations, nonfinancial corporations, and households and nonprofit institutions serving households.

3.3 On the classification of financial instruments, the *Guide* gives prominence to five categories of instruments in particular: debt securities, loans, currency and deposits, trade credit and advances, and special drawing rights (SDRs). There is also an *other debt liabilities* category; this would include items such as insurance, pension, and standardized guarantee schemes, and other accounts payable-other. This chapter explains the nature of these types of financial instruments in the context of the *BPM6* functional categories from which they are drawn. Further, Appendix I defines specific financial instruments and transactions and provides classification guidance; it therefore should be consulted in conjunction with this chapter.

## **B.** Institutional Sectors

3.4 The institutional sector presentations below are consistent with the 2008 SNA and BPM6.<sup>1</sup>

3.5 The **central bank** sector is identical to the definition of that subsector in the 2008 SNA.<sup>2</sup> The central bank is the financial institution (or institutions) that exercises control over key aspects of the financial system. It carries out such activities as issuing currency, managing international reserves, transacting with the IMF; and providing credit to deposit-taking corporations.<sup>3</sup> If an institutional unit is mainly engaged in central banking activities, the entire unit is classified in the central bank sector. The central bank sector includes the following

<sup>&</sup>lt;sup>1</sup> Institutional sectors are also described in detail in Chapter 4 of the 2008 SNA and of BPM6.

<sup>&</sup>lt;sup>2</sup> The central bank is a subsector of the financial corporations sector in the 2008 SNA.

<sup>&</sup>lt;sup>3</sup> The central bank of a currency union is classified as a central bank in the data for the currency union as a whole; in the data of individual member states, it is part of the rest of the world sector.

resident units: (a) central banks<sup>4</sup>, which in most economies are separately identifiable institutions that are subject to varying degrees of government control, engage in differing sets of activities, and are designated by various names (e.g., central bank, reserve bank, national bank, or state bank); (b) currency boards or independent currency authorities that issue national currency that is fully backed by foreign exchange reserves; and (c) government-affiliated agencies<sup>5</sup> that are separate institutional units and primarily perform central bank activities. In economies in which some central banking functions are performed wholly or partly outside the central bank, particularly holding reserve assets, consideration should be given to compiling supplementary data for the monetary authorities.<sup>6</sup>

3.6 The **deposit-taking corporations except the central bank** sector is identical with the corresponding subsector in the 2008 SNA.<sup>7</sup> Included are all resident units engaging in financial intermediation as a principal activity and having liabilities in the form of deposits payable on demand, transferable by check, or otherwise used for making payments, or having liabilities in the form of deposits that may not be readily transferable, such as short-term certificates of deposit, but that are close substitutes for deposits. Thus, in addition to commercial banks<sup>8</sup>, the deposit-taking corporations, except the central bank sector encompasses institutions such as savings banks (including trustee saving banks and savings and loan associations), credit unions or cooperatives, traveler's check companies, and specialized banks or other financial institutions if they take deposits or issue close substitutes for deposits. Post office savings banks or other government-controlled savings banks are also included if they are institutional units

<sup>&</sup>lt;sup>4</sup> Many central banks regulate or supervise other deposit-taking corporations and other financial corporations, and these central bank activities also are included in the central bank sector. However, units that are affiliated with the government or with other sectors and are mainly engaged in regulating or supervising financial units are classified as financial auxiliaries rather than as units in the central bank sector. Private units that perform activities such as check-clearing operations are assigned to other financial corporations subsector depending on their activities, rather than to the central bank.

<sup>&</sup>lt;sup>5</sup> In some countries, the central government may include units that engage in financial transactions that in other countries would be performed by the central bank. When the units in question remain financially integrated with central government and under the direct control and supervision of central government, they cannot be treated as separate institutional units. Moreover, monetary authority functions carried out by central government are recorded in the government sector and not the financial corporation sector (See *2008 SNA*, paragraph 4.139).

<sup>&</sup>lt;sup>6</sup> Monetary authorities encompass the central bank and certain operations usually attributed to the central bank but sometimes carried out by other government institutions or commercial banks, such as government-owned commercial banks. Such operations include the issuance of currency; maintenance and management of reserve assets, including those resulting from transactions with the IMF; and operation of exchange stabilization funds.

<sup>&</sup>lt;sup>7</sup> In the IMF's *Monetary and Financial Statistics Manual*, other depository corporations are defined to include only those financial intermediaries issuing deposits and close substitutes that are included in the national definition of broad money, which may exclude (include) institutional units that are included (excluded) within the 2008 SNA definition of deposit-taking corporations, except the central bank. Rather than as banks, these excluded institutional units would be classified as other financial corporations (or vice versa). While it is recommended in the *Guide* that the definition of deposit-taking corporations, except the central bank be consistent with the 2008 SNA and BPM6, it is recognized that countries may rely on data from monetary surveys to compile external debt statistics for the banking sector.

<sup>&</sup>lt;sup>8</sup> Also, included are "universal banks", and "all purpose" banks.

separate from the government. Deposit-taking corporations that engage exclusively (or almost exclusively) with nonresidents, often called offshore banks or offshore banking units, are included in the deposit-taking corporations sector, but they may be excluded from the money-issuing sector because their liabilities are not included in broad money.

3.7 The general government sector is identical with the definition of that sector in the 2008SNA. The government units of a country consists of those authorities and their agencies that are units established by political processes and exercise legislative, judicial, and executive authority over other institutional units within a given territorial area. The principal economic functions of a government are (1) to assume responsibility for the provision of goods and services to the community on a nonmarket basis, either for collective or individual consumption, and (2) to redistribute income and wealth by means of transfer payments, and (3) to engage in nonmarket production. An additional characteristic of a government unit is that its activities must be financed primarily by taxation or other compulsory transfers. General government sector consists of (i) government units that exist at each level-central, state, or local-of government within the national economy; (ii) all social security funds operated at each level of government; (iii) all nonmarket nonprofit institutions that are controlled and mainly financed by government units, and (iv) government units that are located abroad and are largely exempt from the laws of the territory in which they are located, such embassies, consulates, and military bases. Public corporations and unincorporated corporations that function as if they were corporations (socalled quasi-corporations) are explicitly excluded from the general government sector and are allocated to the financial corporations or nonfinancial corporation sectors, as appropriate. A quasi-corporation can be owned by a resident or nonresident entity but typically will keep a separate set of accounts from its parent and/or, if owned by a nonresident, be engaged in a significant amount of production in the resident economy over a long or indefinite period of time.

3.8 The **other sectors** category comprises other financial corporations (i.e. other than deposit-taking corporations), nonfinancial corporations, and households and nonprofit institutions serving households (NPISHs) subsectors.

3.9 The *other financial corporations* subsector comprises the following types of institutions all of which are resident subsectors in the *2008 SNA*:

- Money market funds (MMFs) are collective investment schemes that raise funds by issuing shares or units to the public. Because their proceeds are primarily invested in short-term money market securities such as treasury bills, certificates of deposits, and commercial paper, and they can provide unrestricted check writing privileges, their shares and units may be regarded as close substitutes for deposits.
- Non-MMF investment funds are collective investment schemes that raise funds by issuing shares or units to the public. Because their proceeds are predominantly invested in long-term financial assets and nonfinancial assets (usually real estate), their shares and units are generally not close substitutes for deposits.
- Other financial intermediaries (except insurance corporations and pension funds) consist of financial corporations or quasi-corporations that are engaged in providing financial services

by incurring liabilities (in forms other than currency, deposits, or close substitutes for deposits) on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market, and that are not included in any other subsector. The following financial intermediaries are classified in this subsector: (a) financial corporations engaged in securitization of assets, (b) underwriters, and security and derivatives dealers (on own account), (c) financial corporations engaged in lending, including financial leasing, as well as personal or commercial finance, (d) central clearing counterparties that provide clearing and settlement of market transactions in securities and derivatives, (e) specialized financial corporations that assist other corporations in raising funds in equity and debt markets (sometimes called "investment banks"), and (f) any other specialized financial corporations that provided short-term financing for corporate mergers and takeovers, export and import finance, factoring companies, and venture capital and development capital firms.

- Financial auxiliaries consist of all financial corporations that engage primarily in activities closely related to financial intermediation but that do not themselves perform an intermediation role, such as security brokers, loan brokers, and insurance brokers.<sup>9</sup>
- Captive financial institutions<sup>10</sup> and moneylenders consist of institutional units providing financial services other than insurance, where most of either their assets or liabilities are not transacted on open financial markets.
- Insurance corporations consist of incorporated, mutual, and other entities whose principal function is to provide life, accident, health, fire, and other types of insurance to individual institutional units or groups of units through the pooling of risk or reinsurance services to other insurance corporations, and
- Pension funds are those that are constituted in such a way that they are separate institutional units from the units that create them and are established for purposes of providing benefits on retirement for specific groups of employees (and, perhaps, their dependents). These funds have their own assets and liabilities and engage in financial transactions on the market on their own account.

3.10 The *nonfinancial corporations* subsector consists of resident entities whose principal activity is the production of market goods or nonfinancial services. This sector is defined consistently with the definition in the 2008 SNA. The sector includes all resident nonfinancial corporations; all resident nonfinancial quasi-corporations, including the branches or agencies of foreign-owned nonfinancial enterprises that are engaged in significant amounts of production on the economic territory on a long-term basis; and all resident nonprofit institutions that are market producers of goods or nonfinancial services.

<sup>&</sup>lt;sup>9</sup> Corporations that facilitate financial transactions, such as central clearing counterparties, stock exchanges, derivative exchanges, and repurchase agreement settlement institutions are financial intermediaries, if they generally act as principals to the counterparties to the underlying transactions; otherwise they are financial auxiliaries.

<sup>&</sup>lt;sup>10</sup> For a list of units included in this subsector, see *BPM6*, paragraph 4.83.

3.11 The *households and NPISHs* subsector comprises the household subsector, consisting of resident households, and the NPISHs subsector, consisting of such resident entities as professional societies, political parties, trade unions, charities, etc. A household is defined as a group of persons who shares the same living accommodations, who pool some or all of their income and wealth, and who consume certain types of goods and services collectively, mainly housing and food. NPISHs are entities mainly engaged in providing goods and services to households or the community largely free of charge or at prices that are not economically significant (and thus are classified as nonmarket producers). Those NPISHs that are controlled and mainly financed by government units are classified in the general government sector.

3.12 In the presentation of the gross external debt position (see below), *intercompany lending* liabilities under a direct investment relationship are separately identified. These data are not further broken down by institutional sectors. Equity liabilities arising from a direct investment, like all equity and investment fund shares liabilities are excluded from external debt. These instruments are described in more detail in paragraph 3.14.

## C. Instrument Classification

3.13 This section defines the types of financial instruments to be included in the presentation of the gross external debt position. They are defined in the context of the *BPM6* functional categories<sup>11</sup>–direct investment, portfolio investment, financial derivatives (other than reserves) and ESOs, other investment, and reserve assets–from which they are drawn. This allows the compiler, if necessary, to derive the gross external debt position data from the IIP statement, or to reconcile both statements.

3.14 **Direct investment** (Table 3.1) is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy.<sup>12</sup> Control or influence may be achieved directly by owning equity that gives voting power in the enterprise, or indirectly by having voting power in another enterprise that has voting power in the enterprise. Accordingly, two ways of having control or influence are identified: (a) immediate direct investment relationships arise when a direct investor directly owns equity that entitles it to 10 percent or more of the voting power in the direct investment enterprise<sup>13</sup>, and (b) indirect direct investment enterprise that owns voting power in another enterprise or enterprises, that is, an entity is able to exercise indirect control or influence through a chain of direct investment relationships. In addition to direct investment relationships between two enterprises that arise because one enterprise controls or influences the other, there are also direct investment relationships between two

<sup>&</sup>lt;sup>11</sup> For additional information about *BPM6* functional categories, see *BPM6*, Chapter 6.

<sup>&</sup>lt;sup>12</sup> The definition of direct investment is the same as in *BPM6* and in the *OECD Benchmark Definition of Foreign Direct Investment*, fourth Edition (OECD, 2008, <u>http://www.oecd.org</u>).

<sup>&</sup>lt;sup>13</sup> In practice, effective control or influence may arise in some cases with less than this percentage. Nevertheless, these definitions should be used in all cases for international consistency and to avoid subjective judgments.

enterprises that do not control or influence each other, but that are both under the control or influence of the same investor (that is, fellow enterprises).

Table 3.1. Standard Components of the IIP: Direct Investment		
Assets	Liabilities	
Equity and investment fund shares	Equity and investment fund shares	
Direct investor in direct investment enterprises	Direct investor in direct investment enterprises	
Direct investment enterprises in direct investor (reverse investment)	Direct investment enterprises in direct investor (reverse investment)	
Between fellow enterprises	Between fellow enterprises	
Debt instruments	Debt instruments 1/	
Direct investor in direct investment enterprises	Direct investor in direct investment enterprises	
Direct investment enterprises in direct investor	Direct investment enterprises in direct investor	
Between fellow enterprises	Between fellow enterprises	
1/Instruments in these categories are debt liabilities to be included in gross external debt position.		

3.15 Direct investment is classified according to the relationship between the investor and the entity receiving the investment, namely: (1) investment by the direct investor in its direct investment enterprise (whether in an immediate relationship or not); (2) reverse investment by a direct investment enterprise in its own immediate or indirect direct investor; and (3) investment between resident and nonresident fellow enterprises. These three categories reflect different types of relationships and motivations (see more detail in *BPM6*, Chapter 6).

3.16 Once established, all financial claims of the investor on the enterprise, and vice versa, and all financial claims on, or liabilities to, related (affiliated) enterprises, are included under direct investment (with two exceptions: financial derivatives and ESOs, and certain intercompany assets and liabilities between two affiliated financial intermediaries—see paragraph 3.20). Of the direct investment components, debt instruments, when owed to nonresident direct investors or affiliates, are included in the gross external debt position; but equity and investment fund shares are not.

3.17 *Debt instruments* cover borrowing and lending of funds–including debt securities and suppliers' credits (for example, trade credits and advances)–among direct investors and related subsidiaries, branches, and associates.<sup>14</sup> In the gross external debt position tables, debt instruments are presented as *direct investment: intercompany lending*.

3.18 *Equity and investment fund shares* (comprising equity in branches, subsidiaries, and associates–except nonparticipating preferred shares, which are classified as debt instruments–reinvestment of earnings, and other capital contributions, such as the provision of machinery) are not debt instruments; hence, they are not included in gross external debt position.

3.19 In practice, it is sometimes difficult to distinguish whether the claims of a direct investor on a direct investment enterprise are debt instruments, which are classified as external debt, or equity and investment fund shares, which are not. Differentiation is particularly difficult when an enterprise is 100 percent owned by a direct investor, such as when the direct investment enterprise is a branch or unincorporated enterprise. In these situations, the classification of

<sup>&</sup>lt;sup>14</sup> Debt instruments-other than monetary gold, SDRs, currency, interbank positions, and pension and related entitlements-can potentially be included in direct investment. Insurance technical reserves are included in direct investment when the parties are in a direct investment relationship. Borrowing for fiscal purposes through a nonresident entity owned or controlled by the government should be included in general government and not direct investment (see Appendix I, Part 2).

capital could be the same as used in the direct investment enterprise's accounting records. That is, when a claim of the direct investor on the direct investment enterprise is considered to be equity or shareholder funds in the accounting records of the direct investment enterprise, this claim is also considered equity and investment fund shares for external debt purposes. Subject to this condition: if liabilities are only to be repaid in the event that a profit is made by the direct investment enterprise, then the liabilities are classified as equity and investment fund shares. Similarly, in some instances the direct investor might fund local expenses directly and also receive directly the income arising from the output of the direct investment enterprise. The *Guide* regards such payments and receipts as the provision and withdrawal of equity and investment fund shares, respectively, in the direct investment enterprise by the direct investor.

3.20 The positions of intercompany assets and liabilities between two affiliated financial intermediaries, including special purpose entities (SPEs), principally engaged in financial intermediation, that are recorded under direct investment are limited to equity and investment fund shares, including reinvestment of earnings, and debt between captive financial institutions and money lenders, insurance corporations, pension funds, and financial auxiliaries.<sup>15</sup> Other intercompany debt liabilities between two affiliated financial intermediaries are classified by type of instrument, such as loans, debt security, etc., and are attributed to the institutional sector of the debtor entity. For this purpose, financial intermediaries engaged in providing financial intermediation services comprise those corporations and quasi-corporations, except the central bank; (2) MMFs; (3) non-MMF investment funds; and (4) other financial intermediaries, except insurance corporations and pension funds. Debt between these financial intermediaries is not classified as direct investment because it is not considered to be so strongly connected to the direct investment relationship.

3.21 **Portfolio investment** (Table 3.2) includes securities (other than those included in direct investment and reserve assets). These instruments have the characteristic feature of negotiability<sup>16</sup> and are usually traded (or tradable) in organized and other financial markets, including over-the-counter (OTC) markets. When they are owed to nonresidents, debt securities are included in the gross external debt position. Equity securities, including share investments in mutual funds and investment trusts,<sup>17</sup> are not included in the gross external debt position.

3.22 Debt securities issued with an original maturity of more than one year are classified as long-term securities, even though their remaining maturity at the time of the investment may be less than one year. Long-term securities usually give the holder the unconditional right to a

<sup>&</sup>lt;sup>15</sup> Both affiliated parties must be one of the selected types of financial corporations, but they need not be the same type.

<sup>&</sup>lt;sup>16</sup> Negotiability means that legal ownership can be transferred from one unit to another by delivery or endorsement.

<sup>&</sup>lt;sup>17</sup> A mutual fund or investment trust liability that requires payment(s) of principal and/or interest by the mutual fund or investment trust to the creditor at some point(s) in the future is to be recorded as a debt instrument and, if owed to nonresidents, included in the gross external debt position. The instrument classification would be dependent on the characteristics of the liability–for example, as a deposit (see paragraph 3.34).

fixed money income or contractually determined variable money income (payment of interest being independent of the earnings of the debtor). With the exception of perpetual bonds, longterm securities also provide the unconditional right to a fixed sum in repayment of principal on a specified date or dates. Included among long-term securities are so-called asset-backed securities and collateralized debt obligations; that is, securities on which payments to creditors are explicitly dependent on a specific stream of income—for example, future lottery receipts or a pool of nonnegotiable instruments (say, loans or export receivables); see Appendix I for more details.

Table 3.2. Standard Components of the IIP: Portfolio Investment				
Assets	Liabilities			
Equity and investment fund shares	Equity and investment fund shares			
Central bank	Deposit-taking corporations, except the central bank			
Deposit-taking corporations, except the central bank	Other sectors			
General government	Other financial corporations			
Other sectors	Nonfinancial corporations, households, and NPISHs			
Other financial corporations	Debt securities 1/			
Nonfinancial corporations, households, and NPISHs	Central bank			
Debt securities	Long-term			
Central bank	Short-term			
Long-term	Deposit-taking corporations, except the central bank			
Short-term	Long-term			
Deposit-taking corporations, except the central bank	Short-term			
Long-term	General government			
Short-term	Long-term			
General government	Short-term			
Long-term	Other sectors			
Short-term	Long-term			
Other sectors	Short-term			
Long-term	Other financial corporations			
Short-term	Long-term			
Other financial corporations	Short-term			
Long-term	Nonfinancial corporations, households, and NPISHs			
Short-term	Long-term			
Nonfinancial corporations, households, and NPISHs	Short-term			
Long-term				
Short-term				

1/ Instruments in these categories are debt liabilities to be included in the gross external debt position.

3.23 Debt securities issued with an original maturity of one year or less are classified as short-term securities. These instruments generally give the holder the unconditional right to receive a stated, fixed sum of money on a specified date. Short-term securities are usually traded, at a discount, in organized markets; the discount is dependent on the interest rate and the time remaining to maturity. Examples of short-term securities include treasury bills, commercial and financial paper, and bankers' acceptances. Like long-term securities, short-term securities can be "backed" by a specific stream of income or pool of nonnegotiable instruments.

3.24 Further, where an instrument is provided by an importer to an exporter with such characteristics that it is negotiable in organized and other financial markets, such as a promissory note, it should be classified as a debt security–either long-term or short-term depending on its original maturity–in the gross external debt position. Separate identification of the outstanding value of such instruments is also encouraged because of their role in financing trade. (See also the description of trade-related credit in Chapter 6.)

3.25 *Equity and investment fund shares* cover all instruments and records acknowledging, after the claims of all creditors have been met, claims to the residual value of incorporated enterprises. These securities are not debt instruments and so are not external debt liabilities. Shares, stocks, preferred stock or shares, participation, or similar documents-such as American Depository Receipts-usually denote ownership of equity. Shares of collective investment institutions, e.g., mutual funds and investment trusts, are also included.

3.26 *Financial derivatives (other than reserves) and ESOs* (Table 3.3) are financial assets and liabilities that have similar features, such as a strike price and some of the same risks elements. However, although both transfer risk, ESOs are also designed to be a form of remuneration. A financial derivative contract is a financial instrument that is linked to a specific financial instrument, indicator, or commodity and through which specific financial risks can be traded in financial markets in their own right. ESOs are options to buy the equity of a company, offered to employees of the company as a form of remuneration. As explained in Chapter 2 (see paragraph 2.11), financial derivatives and ESOs are not debt instruments, but information on them can be relevant for external debt analysis.

Table 3.3. Standard Components of the IIP: Financial Derivatives (other than reserves) and employee stock options (ESOs)		
Assets	Liabilities	
Financial derivatives (other than reserves) and ESOs $^{1/}$	Financial derivatives (other than reserves) and ESOs	
Central bank	Central bank	
Deposit-taking corporations, except the central bank	Deposit-taking corporations, except the central bank	
General government	General government	
Other sectors	Other sectors	
Other financial corporations	Other financial corporations	
Nonfinancial corporations, households, and NPISHs	Nonfinancial corporations, households, and NPISHs	

1/ Excludes financial derivatives that pertain to reserve assets management and are included in reserves assets data.

3.27 They are two broad types of financial derivatives- forward-type and option contracts. Under a *forward-type contract* (*forward*), the two counterparties agree to exchange an underlying item- real or financial-in a specified quantity, on a specified date, at an agreed contract (strike) price or, in the specific instance of a swap contract, the two counterparties agree to exchange cash flows, determined with reference to the price(s) of, say, currencies or interest rates, according to prearranged rules. The typical requirement under a foreign exchange forward contract to deliver or receive foreign currency in the future can have important implications for foreign currency liquidity analysis and is captured in the table in Table 7.10 in Chapter 7. Under an *option contract* (option), the purchaser of the option, in return for an option premium, acquires from the writer of the option the right but not the obligation to buy (call option) or sell (put option) a specified underlying item-real or financial-at an agreed contract (strike) price on or before a specified date. Throughout the life of the contract, the writer of the option has a liability and the buyer an asset, although the option can expire worthless; the option will be exercised only if settling the contract is advantageous for the purchaser. Typical derivatives instruments include futures (exchange traded forward contract), interest and cross-currency swaps, forward rate agreements, forward foreign exchange contracts, credit derivatives, and various types of options.

3.28 *Other investment* (Table 3.4) covers all financial instruments other than those classified as direct investment, portfolio investment, financial derivatives and ESOs, or reserve assets. When owed to nonresidents, all the components of other investment, except other equity, are included in the gross external debt position; that is, currency and deposits; loans; insurance,

pension, and standardized guarantee schemes; trade credit and advances; other accounts payable-other; and SDR allocations.

3.29 *Other equity* included in other investment, is equity that is not in the form of securities, nor included in direct investment or reserve assets. The ownership of many international organizations is not in the form of shares and so is classified as other equity (although equity in the Bank for International Settlements (BIS) is in the form of unlisted shares and it is classified as portfolio investment). Ownership of currency union central banks is included in other equity.

3.30 *Currency and deposits* consists of notes and coins and deposits (both transferable and other).<sup>18</sup> Notes and coins represent claims of a fixed nominal value usually on a central bank or government; commemorative coins are excluded. Deposits include all claims that are (a) on the central bank, deposit-taking corporations other than the central bank, and, in some cases, other institutional units; and (b) represented by evidence of deposit. Transferable deposits consist of all deposits that are (1) exchangeable for bank notes and coins on demand at par and without penalty or restriction, and (2) directly usable for making payments by check, draft, giro order, direct debit/credit, or other direct payment facility. Other deposits comprise all claims, other than transferable deposits; nonnegotiable CDs; 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. Unallocated accounts for precious metals (including unallocated gold accounts) are also deposit liabilities.<sup>19</sup>

<sup>&</sup>lt;sup>18</sup> It is recommended that all currency and deposits are included in the short-term category unless detailed information is available to make the short-term/long-term attribution.

<sup>&</sup>lt;sup>19</sup> An unallocated gold account owned by a monetary authority and held as a reserve asset is included within monetary gold.

Table 3.4. Standard Components of the IIP: Other Investment			
Assets	Liabilities		
Other equity	Other equity		
Currency and deposits	Currency and deposits 1/		
Central bank	Central bank		
Long-term	Long-term		
Short-term	Short-term		
Deposit-taking corporations, except the central bank	Deposit-taking corporations, except the central bank		
Long-term	Long-term		
Short-term	Short-term		
General government	General government		
Long-term	Long-term		
Short-term	Short-term		
Other sectors	Other sectors		
Long-term	Long-term		
Short-term	Short-term		
Other financial corporations	Other financial corporations		
Long-term	Long-term		
Short-term	Short-term		
Nonfinancial corporations households and NPISHs	Loans 1/		
Long-term	Central bank		
Short-term	Credits and loans with the IME (other than reserves)		
Loans	Other short-term		
Central bank	Other long-term		
Credits and loans with the IME (other than reserves)	Deposit-taking corporations except the central bank		
Other short-term	Long-term		
Other long-term	Short-term		
Denosit-taking corporations excent the central bank	General government		
Long-term	Credits and loans with the IME (other than reserves)		
Short-term	Other short-term		
Ceneral government	Other long-term		
Credits and loans with the IME (other than reserves)	Other sectors		
Other short-term	Long-term		
Other long-term	Short-term		
Other sectors	Other financial corporations		
Long-term	Long-term		
Short-term	Short-term		
Other financial corporations	Nonfinancial corporations households and NPISHs		
Long torm	Long torm		
Short torm	Short term		
Nonfinancial corporations households and NPISHs	Insurance pension and standardized quarantee schemes 1/		
Long torm	Control bank		
Short torm	Donosit taking corporations, except the contral bank		
Insurance pension and standardized guarantee schemes	Conoral government		
Control honk	Other sectors		
Denosit taking comparations, except the control hould	Other Sectors		
Conoral government	Nonfinancial comporations households and NDICUS		
Other sectors	Nominancial corporations, nousenoids, and NPISHS		
Other financial comparations			
Nonfinancial comporations households and NDICU-			
Nominancial corporations, nousenolos, and NPISHS			

+

Table 3.4. Standard Components of the IIP: Other Investment (Continued)			
Assets	Liabilities		
Trade credit and advances	Trade credit and advances 1/		
Central bank	Central bank		
Long-term	Long-term		
Short-term	Short-term		
Deposit-taking corporations, except the central bank	Deposit-taking corporations, except the central bank		
Long-term	Long-term		
Short-term	Short-term		
General government	General government		
Long-term	Long-term		
Short-term	Short-term		
Other sectors	Other sectors		
Long-term	Long-term		
Short-term	Short-term		
Other financial corporations	Other financial corporations		
Long-term	Long-term		
Short-term	Short-term		
Nonfinancial corporations, households, and NPISHs	Nonfinancial corporations, households, and NPISHs		
Long-term	Long-term		
Short-term	Short-term		
Other accounts receivableother	Other accounts payableother 1/		
Central bank	Central bank		
Long-term	Long-term		
Short-term	Short-term		
Deposit-taking corporations, except the central bank	Deposit-taking corporations, except the central bank		
Long-term	Long-term		
Short-term	Short-term		
General government	General government		
Long-term	Long-term		
Short-term	Short-term		
Other sectors	Other sectors		
Long-term	Long-term		
Short-term	Short-term		
Other financial corporations	Other financial corporations		
Long-term	Long-term		
Short-term	Short-term		
Nonfinancial corporations, households, and NPISHs	Nonfinancial corporations, households, and NPISHs		
Long-term	Long-term		
Short-term	Short-term		
	Special drawing rights 1/		

1/ Instruments in these categories are debt liabilities to be included in the gross external debt position.

3.31 The nominal value of deposits is usually fixed in terms of the currency in which the deposits are denominated. In some cases, deposits may have their value expressed in terms of an index or linked to a commodity price, for example, gold, oil, or share prices.

3.32 When one party is a deposit-taking corporation and the other is not, a possible convention is that an asset position of a deposit-taking corporation is classified as a loan by both parties. Similarly, a liability of a deposit-taking corporation to another type of entity is classified as a deposit by both parties. In some cases, the instrument classification of interbank positions may be unclear, for example, 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 securities and accounts receivable/payable, are classified under deposits.

3.33 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.

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. Compilers may adopt another treatment if better information is available.

3.34 *Loans* include those financial assets created through the direct lending of funds by a creditor (lender) to a debtor (borrower) through an arrangement in which the lender either receives no security evidencing the transactions or receives a nonnegotiable document or instrument. Collateral, in the form of either a financial asset (such as a security) or nonfinancial asset (such as land or a building) may be provided under a loan transaction, although it is not an essential feature. In the gross external debt position, loans include use of IMF credit and loans from the IMF.

3.35 If a loan becomes negotiable, the loan should be reclassified as a debt security. Given the significance of reclassification, there needs to be evidence of secondary market trading before a debt instrument is reclassified from a loan to a security. Evidence of trading on secondary markets would include the existence of market makers and frequent bid-offer spreads for the debt instrument. The *Guide* encourages the separate identification of the outstanding value of any such loans reclassified.

3.36 Reverse security transactions and financial leases are two types of arrangements for which the change of ownership principle is not strictly adhered to.

3.37 A reverse securities transaction is defined to include all arrangements whereby one party legally acquires securities and agrees, under a legal agreement at inception, to return the same or equivalent securities on or by an agreed date to the same party from whom they acquired the securities initially. If the security taker under such a transaction provides cash funds, and there is agreement to reacquire the same or equivalent securities at a predetermined price at the contract's maturity, a loan transaction is recorded. This is the so-called collateralized loan approach to a reverse securities transaction, with the securities representing the collateral. These transactions include security repurchase agreements (repos), securities lending involving cash, and sale/buy backs. The security provider under a reverse security transaction acquires a repo loan liability and the security taker a repo loan asset. If no cash is provided, no loan transaction is reported. Under the collateralized loan approach, the security is assumed not to have changed ownership and remains on the balance sheet of the security provider. A similar recording procedure is adopted for transactions where gold rather than securities is provided as collateral for cash (so-called gold swaps).

3.38 If the security taker sells the security acquired under a reverse security transaction, it records a negative position in that security. This treatment reflects economic reality in that the holder of the negative position is exposed to the risks and benefits of ownership in an equal and opposite way to the party who now owns the security (see also Appendix II). On-selling of gold by the gold taker, similarly reported as a negative holding, does not affect the gross external debt position because gold is an asset without any corresponding liability.

3.39 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. In other words, the lessee becomes the economic owner of the assets (*BPM6*, paragraph 5.56). The lessee contracts

to pay rentals for the use of a good for most or all of its expected economic life. The rentals enable the lessor over the period of the contract to recover most or all of the costs of goods and the carrying charges. While there is not a legal change of ownership of the good, under a financial lease the risks and rewards of ownership are, de facto, transferred from the legal owner of the good, the lessor, to the user of the good is imputed to have changed economic statistical convention, the total value of the good is imputed to have changed economic ownership. Therefore, the debt liability at the 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. The loan is repaid through the payment of rentals (which comprise both interest and principal payment elements) and any residual payment at the end of the contract (or alternatively, by the return of the good to the lessor).

3.40 *Insurance, pension, and standardized guarantee schemes* comprises (a) nonlife insurance technical reserves; (b) life insurance and annuity entitlements; (c) pension entitlements, claims of pension funds on pension managers, and entitlements to nonpension funds; and (d) provisions for calls under standardized guarantees. These reserves, entitlements, and provisions represent liabilities of the insurer, pension fund, or issuer of standardized guarantees, and a corresponding asset of the policyholders or beneficiaries. The aggregate values of liabilities can be estimated actuarially because the company or fund has a pool of liabilities, but the value is less clear for the asset holders. The insurers, pension funds, and guarantors usually hold a range of assets to allow them to meet their obligations; however, these are not necessarily equal to the provision and entitlement liabilities.

3.41 *Trade credit and advances* consist of claims or liabilities arising from the direct extension of credit by suppliers for transactions in goods and services, and advance payments by buyers for goods and services and for work in progress (or to be undertaken). Long- and short-term trade credits are shown separately. Trade-related loans provided by a third party, such as a bank, to an exporter or importer are not included in this category but under loans, above (see also the description of a wider concept of trade-related credit— which also captures other credits provided to finance trade activity, including through banks —in Chapter 6). Progressive payments (or stage payments) on high-value capital goods—such as ships, heavy machinery, and other structures that may take years to complete—do not give rise to trade credit and advances unless there is a difference in timing between the change in ownership of these high value goods and the payments.

3.42 *Other accounts receivable/payable-other* covers items other than other equity; currency and deposits; loans; insurance, pension, and standardized guarantee schemes; trade credit and advances; and SDR allocations. Such assets and liabilities include some arrears (see below); and accounts receivable and payable, such as in respect of taxes, purchases and sales of securities, securities lending fees, gold loan fees, wages and salaries, dividends, and social contributions that have accrued but not yet paid.<sup>20</sup>

<sup>&</sup>lt;sup>20</sup> Accrued interest costs should be recorded with the financial asset or liability on which they accrue, not in other accounts receivable/payable. Nevertheless, for fees on securities lending and gold loan (which are treated as interest by convention) the corresponding entries are included in other accounts receivable/payable, rather than with the instrument to which they relate.

3.43 Arrears are defined as amounts that are past due-for-payment and unpaid. Arrears can arise both through the late payment of principal and interest on debt instruments (which are recorded in the original debt instrument) as well as through late payments for other instruments and transactions. For instance, a financial derivatives contract is not a debt instrument for reasons explained above, but if a financial derivatives contract comes to maturity and a payment is required but not made, arrears are created and recorded as other debt liabilities in the gross external debt position. Similarly, if goods and/or services are supplied and not paid for on the contract payment date or a payment for goods and/or services is made but the goods and/or services are not delivered on time, then arrears are created. These debt liabilities for late payments or late delivery of goods and/or services should be recorded as trade credit and advances in the gross external debt position.<sup>21</sup>

3.44 A special circumstance may arise when the creditor has agreed in principle to reschedule debt-that is, reorganize payments that are falling due-but the agreement has yet to be signed and implemented. In the meantime, payments due under the existing agreement are not made, and arrears arise-so-called technical arrears.<sup>22</sup> Such arrears might typically arise in the context of Paris Club agreements between the time of the Paris Club rescheduling session and the time when the bilateral agreements are signed and implemented. If the agreement in principle lapses before the agreement is signed, then any accumulated arrears are no longer technical arrears.

3.45 *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 monetary authorities of IMF members and a limited number of international financial institutions that are authorized holders. SDR holdings (assets) represent unconditional rights to obtain foreign exchange or other reserve assets from other IMF members. SDR allocations are recorded as the incurrence of a long-term debt liability of the member receiving them (because of a requirement to repay the allocation in certain circumstances, and also because interest accrues). The holdings and allocations should be shown gross, rather than netted. SDR allocations are included in the gross external debt position.

3.46 *Reserve assets* (Table 3.5) are those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing). Reserve assets must be foreign currency assets and assets that actually exist.<sup>23</sup> By definition, reserve assets are not included in the gross external debt position.

<sup>&</sup>lt;sup>21</sup> A detailed discussion about the treatment and typology of arrears is presented in Appendix 7.

 $<sup>^{22}</sup>$  If the creditor bills and the debtor pays on the basis of the new agreement, even though it is not signed, no arrears arise.

<sup>&</sup>lt;sup>23</sup> In addition to *BPM6*, Chapter VI, see *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template* (2011-Update), which also provides guidance on the measurement of official reserve assets.

Table 3.5. Standard Components of the IIP: Reserve Assets		
Assets		
Monetary gold		
Gold bullion		
Unallocated gold accounts		
Special drawing rights		
Reserve position in the IMF		
Other reserve assets		
Currency and deposits		
Claims on monetary authorities		
Claims on other entities		
Securities		
Debt securities		
Short-term		
Long-term		
Equity and investment funds shares		
Financial derivatives		
Other claims		

3.47 *Reserve related liabilities* are defined as foreign currency liabilities of the monetary authorities that can be considered as direct claims by nonresidents on the reserve assets of an economy. They include: (1) SDR allocations, (2) loans from the IMF to monetary authorities, (3) foreign currency loan and deposit liabilities of the monetary authorities to nonresidents (including those arising from foreign currency swaps with other central banks, loans from BIS, and from other deposit-takers); (4) foreign currency loan liabilities to nonresidents associated with securities that the monetary authorities have repoed out; (5) foreign currency securities issued by the monetary authorities and owed to nonresidents; and (6) other foreign currency liabilities to nonresidents, including foreign currency accounts payable and financial derivatives—recorded on a net basis (liabilities less assets)—settled in foreign currency and associated with, but not within the definition of, reserve assets (see above). Liabilities to residents and liabilities that are both denominated and settled in domestic currency are not included.

## 4. PRESENTATION OF THE GROSS EXTERNAL DEBT POSITION

### A. Introduction

4.1 This chapter provides a table for the presentation of the gross external debt position and related memorandum tables. Data compiled using the concepts and definitions outlined in the previous chapters and presented in the format of this table are essential to providing a comprehensive and informed picture of the gross position for the whole economy, and so their dissemination on a frequent basis is encouraged (See also Box. 4.1).

4.2 In disseminating data on the gross external debt position, compilers are encouraged to provide methodological notes (metadata) explaining the concepts, definitions, and methods used in compiling the data. For any presentation of gross external debt position, it is particularly important for the compiler to clearly indicate whether debt securities are valued at nominal or market value<sup>1</sup> (see paragraph 2.33), and whether interest costs that have accrued but are not yet payable are included, or not.

#### Box 4.1 SDDS and GDDS Specifications Regarding Dissemination of External Debt Statistics

In the aftermath of the 1994-95 international financial crisis, the Interim Committee (now called the International Monetary and Financial Committee) of the IMF's Board of Governors endorsed the establishment of a two-tier standard to guide member countries in the provision of economic and financial data to the public. The first tier, named the Special Data Dissemination Standard (SDDS), was approved by the IMF's Executive Board on March 29, 1996. The other tier, named the General Data Dissemination System (GDDS), was approved on December 19, 1997.

The purpose of the SDDS is to guide IMF member countries in the provision to the public of comprehensive, timely, accessible, and reliable economic and financial statistics in a world of increasing economic and financial integration. The SDDS is geared to those countries that have, or might seek, access to international capital markets. Subscription to the SDDS is voluntary. By subscribing to the SDDS, members undertake to provide the supporting information to the IMF and to observe the various elements of the SDDS.<sup>1/</sup>

With respect to the external debt data category, the SDDS prescribes the dissemination of quarterly data for the whole economy with a one-quarter lag, covering four sectors (general government, central bank, deposit-taking corporations, except the central bank, and other sectors). Data are to be further disaggregated by maturity—short- and long-term—and provided on an original maturity basis and by instrument, as set out in *BPM6*. The SDDS encourages countries to disseminate supplementary information on future debt-service payments, in which the principal and interest components are separately identified, twice yearly for the first four quarters and the following two semesters ahead, with a lag of one quarter. The data should also be broken down into four sectors (general government, central bank, deposit-taking corporations, except the central bank, and other sectors) as set out in *BPM6*. The dissemination of both domestic/foreign currency and remaining maturity breakdowns of external debt with quarterly periodicity and timeliness are also encouraged.

<sup>&</sup>lt;sup>1</sup> A table reconciling nominal and market valuation of debt securities is provided in Chapter 7 (Table 7.17).

The GDDS is a structured process focused on data quality that assists countries in adapting their statistical systems to meet the evolving requirements of the user community in the areas of economic management and development. Participating countries voluntarily commit to adhering to sound statistical practices in developing their statistical systems.

The core data category for external debt in the GDDS includes public and publicly-guaranteed debt, and the associated debt-service schedule. Recommended good practice would be that the position data, broken down by maturity, be disseminated with quarterly periodicity and timeliness of one or two quarters after the reference date. In addition, the associated debt-service schedules should be disseminated twice yearly, within three to six months after the reference period, and with data for four quarters and two semesters ahead. Data on private external debt not publicly guaranteed and debt-servicing schedules, with annual periodicity, are encouraged data categories to be disseminated within six to nine months after the reference period.

<sup>1</sup>On February 22, 2012, the IMF's Executive Board approved the SDDS Plus, as an additional tier of the Fund's Data Standards Initiatives. The SDDS Plus is primarily intended for subscribers to the SDDS with systemically important financial sectors, while contributing to address data gaps revealed in the recent global financial crisis. No changes to the external debt data category are included in the SDDS Plus.

#### **B.** Presentation Table

- 4.3 The presentation of the gross external debt position is set out in Table 4.1.
  - The first level of disaggregation is by institutional sector. The primary disaggregation is by the four sectors of the compiling economy described in the previous chapter—general government, central bank, deposit-taking corporations, except the central bank, and other sectors.<sup>2</sup> A disaggregation of the other sectors into other financial corporations, nonfinancial corporations, and households and nonprofit institutions serving households (NPISHs) is provided.

*Intercompany lending* between entities in a direct investment relationship is separately presented because the nature of the relationship between debtor and creditor is different from that for other debt, and this affects economic behavior. Whereas a creditor principally assesses claims on an unrelated entity in terms of the latter's ability to repay, claims on a related entity may be additionally assessed in terms of the overall profitability and economic objectives of the multinational operation. The different types of intercompany lending liabilities under a direct investment relationship are presented.

- The second level of disaggregation is by the maturity of external debt—short-term and long-term on an original maturity basis. A maturity attribution is not provided for intercompany lending.<sup>3</sup>
- The third level of disaggregation is by type of debt instrument. The debt instruments are described in Chapter 3.

<sup>&</sup>lt;sup>2</sup> In economies in which some central banking functions are performed wholly or partly outside the central bank, supplementary data for the monetary authorities sector (as defined in chapter 3) could be considered. <sup>3</sup> If a short-/long-term maturity attribution of intercompany lending data is available to the compiler on an original maturity basis, the *Guide* encourages dissemination of these data.

Table 4.1 Gross External Debt Position: By Sector	
	End Period
General Government	
Short-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term	
Special drawing rights (SDRs), Allocation	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Central Bank	
Short-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term	
Special drawing rights (SDRs), Allocation	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Deposit-Taking Corporations, except the Central Bank	
Short-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/3/	
Long-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Other Sectors	
Short-term	
Currency and denosits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/3/	
Long-term	
Currency and denosits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt lisbilities 2/	
other debt habilities 2/	l

Table 4.1. Gross External Debt Position: By Sector (Continued)	
	End Period
Other financial corporations	
Short-term	
Currency and deposits 1/	
Loons	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Nonfinancial corporations	
Short-term	
Dabt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/3/	
Long-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Households and nonprofit institutions serving households (NPISHs)	
Short-term	
Dobt acquities	
Leans	
Trade credit and advances	
Other debt liabilities 2/3/	
Long-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Direct Investment: Intercompany Lending	
Debt liabilities of direct investment enterprises to direct investors	
Debt liabilities of direct investors to direct investment enterprises	
Gross External Debt Position	
Mamarandum Itama	
Arrears: By Sector 3/	
General government	
Central bank	
Deposit-taking corporations, except the central bank	
Other sectors	
Other financial corporations	
Nonfinancial corporations	
Households and nonprofit institutions serving households (NPISHs)	
Direct investment: Intercompany lending	
Debt Securities: By Sector 4/	
General government	
Snort-term	
Central bank	
Short-term	
Long-term	
Deposit-taking corporations, except the central bank	
Short-term	
Long-term	
Other sectors	
Short-term	
Long-term	
Other financial corporations	
Snort-term	
Long-term Nonfinancial corporations	
Short-term	
Long-term	
Households and nonprofit institutions serving households (NPISHs)	
Short-term	
Long-term	
1/ It is recommended that all currency and deposits be included in the short-term category unle	ess detailed information is
available to make the short-term/long-term attribution.	

2/ Other debt liabilities comprise insurance, pension, and standarized guarantee schemes, and other accounts payable -

2/ Other deer habitities comprise instance, persion, and standarized guarance contact, and the result of the standarized guarance contact, and the standarized guarance contact

4.4 Total value of arrears and debt securities by sector are separately identified in memorandum items to Table 4.1, Arrears are recorded in the original instrument until the liability is extinguished, and are presented in nominal value in the memorandum items. Such information is of particular analytical interest to those involved in external debt analysis, since the existence of arrears indicates the extent to which an economy has been unable to meet its external obligations.

4.5 This *Guide* recommends that both nominal and market values be provided for debt securities (see paragraph 2.33). Nevertheless, most economies disseminate debt securities data only on a single valuation basis (either nominal or market value basis). As a consequence, inconsistencies may arise in macroeconomic analysis and cross-country data comparisons on external debt. To fully articulate the *Guide*'s recommendation on the valuation basis, debt securities data should be valued in memorandum items to Table 4.1, either at market value if they are presented at nominal value in the table, or at nominal value if they are presented at market.<sup>4</sup>

4.6 The sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* gives increased emphasis to the international investment position (IIP) statistics in international accounts compilation and analysis. Provided that debt securities are valued at market value, the gross external debt position as presented in the *Guide*, equals the debt liabilities in the IIP statement; i.e., total IIP liabilities excluding all equity (equity shares and other equity) and investment fund shares and financial derivatives and employee stock options (ESOs) liabilities, allowing comparability across datasets.

4.7 The chapter also presents six memorandum tables with data, which depending on an economy's circumstances, can enhance the analytical usefulness of the data presented in the gross external debt position.

## C. Memorandum Tables

4.8 To enhance analytical usefulness, various memoranda data series might be presented along with the presentation of the gross external debt position. The first memorandum table (Table 4.2) provides information on external debt arrears of the total economy. The second memorandum table provides information on the external debt position by short-term remaining maturity for the total economy. The next three memorandum tables—financial derivatives and ESOs, equity liabilities, and debt securities issued by residents that are involved in reverse security transactions between residents and nonresidents— present information on instruments that are not captured in the gross external debt position. The last memorandum table—guaranteed external debt—presents information on explicit contingent liabilities by sector (part of which are captured in the gross external debt position). These memorandum tables provide information on selected liabilities (current and/or contingent)

<sup>&</sup>lt;sup>4</sup> Debt securities in the memorandum items to Table 4.1 do not include those that may be included in *Direct investment: Intercompany Lending*. However, if significant, additional information on these securities at both nominal and market value could be provided.

that potentially could render an economy vulnerable to solvency and, particularly, liquidity risks.

#### Arrears

4.9 For some economies, arrears are very significant. For these economies, a further disaggregation of arrears into arrears of principal and arrears of interest by institutional sector is encouraged. Also, if the amounts of technical and/or transfer arrears are significant, it is encouraged that data on these amounts be separately identified and disseminated by the compiling economy.

4.10 A memorandum table for the presentation of position data on arrears on external debt by sector is provided in Table 4.2. The memorandum table presents arrears at nominal value because it is a measure of the overdue amount that the debtor owes to the creditor, typically according to the terms of the contract between the two parties.

Table 4.2. Gross External Debt Position: Arrears by Sector 1/2/	
	End Period
General Government	
Principal	
Interest	
Central Bank	
Principal	
Interest	
Deposit-Taking Corporations, except the Central Bank	
Principal	
Interest	
Other Sectors	
Principal	
Interest	
Other financial corporations	
Principal	
Interest	
Nonfinancial corporations	
Principal	
Interest	
Households and nonprofit institutions serving households (NPISHs)	
Principal	
Interest	
Direct Investment: Intercompany Lending	
Principal	
Interest	
Debt liabilities of direct investment enterprises to direct investors	
Principal	
Interest	
Debt liabilities of direct investors to direct investment enterprises	
Principal	
Interest	
Debt liabilities between fellow enterprises	
Principal	
Interest	
Total Economy	
1/ Valued at nominal value.	
2/Interest includes accrued interest on arrears of principal and interest	

## **External Debt by Short-Term Remaining Maturity**

4.11 The *Guide* recommends that in the gross external debt position the short-term/longterm maturity attribution be made on the basis of original maturity; in addition the distinction between long and short-term maturity on a remaining maturity basis is recommended (see

paragraphs 2.60-2.61 and 6.6-6.7). Compiling information on external debt on a short-term remaining maturity basis helps in the assessment of liquidity risk by indicating that part of the gross external debt position that is expected to fall due in the coming year. A memorandum table for the presentation of gross external debt position data by short-term remaining maturity for the total economy is provided in Table 4.3.<sup>5</sup> Short-term remaining maturity external debt is presented by adding the value of outstanding short-term external debt (original maturity) to the value of outstanding long-term external debt (original maturity) due to be paid in one year or less.

Table 4.3. Gross External Debt Position: Short-Term Remaining MaturityTotal Economy	
	End Period
Short-term debt on an original maturity basis	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term debt obligations due for payment within one year or less	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Total Economy	
Memorandum Items	
Arrears (total, all sectors) 3/	
Debt securities 4/	
Short-term debt securities on an original maturity basis	
Long-term debt securities obligations due for payment within one year or less	
1/ It is recommended that all currency and deposits be included in the short-term unless detailed information is available to make the short-term/long-term attribu	category tion.
2/ Other debt liabilities comprise insurance, pension, and standardized guarantee other accounts payable-other in the IIP statement.	es schemes, and
3/ Arrears are recorded in the original debt instrument rather than in other debt	liabilities,
short term.	
4/ Debt securities valued at market value if they are presented at nominal value in	n the table, or at

4/ Debt securities valued at market value if they are presented at nominal value in the table, or at nominal value if they are presented at market value in the table. Debt securities in the memoradum items do not include those that may be included in Direct investment: Intercompany Lending.

4.12 Total value of arrears (if applicable) and debt securities are separately identified in memorandum items to Table 4.3. *Arrears* are recorded in the original debt instrument until the liability is extinguished, and are presented at nominal value in the memorandum items. Therefore, if applicable, arrears may be recorded in any debt instruments presented in the two maturity breakdown of the table.

<sup>&</sup>lt;sup>5</sup> For compiling the data for Table 4.3, direct investment: intercompany lending should be attributed to long-term maturity, unless detailed information is available to provide data on a short-term remaining maturity basis.

4.13 This *Guide* recommends that both nominal and market values be provided for debt securities (see paragraphs 2.33). For this purpose, in memorandum items to Table 4.3, debt securities are valued either at market value if they are presented at nominal value in the table, or at nominal value if they are presented at market value in the table.

## Financial Derivatives and Employee Stock Options (ESOs)

4.14 A memorandum table for the presentation of position data on financial derivatives and ESOs<sup>6</sup> with nonresidents by sector is provided in Table 4.4. Because of the use of financial derivatives to hedge financial positions as well as to take open positions, these contracts can add to an economy's liabilities and, if used inappropriately, cause significant losses. However, in comparing financial derivatives data with external debt position data, the user should be aware that financial derivatives might be hedging asset positions, or a whole portfolio of assets and liabilities. In this regard, the net external debt position presentation in Chapter 7 is also relevant.

4.15 The table includes gross assets as well as gross liabilities because of the market practice of creating offsetting contracts, and the possibility of forward-type instruments to switch from asset to liability positions, and vice versa, from one period to the next. For instance, a borrower hedging a foreign currency borrowing with a forward contract might find that the value of the hedge switches from asset to liability position from period to period depending on the movement in exchange rates. To present only the liability position in financial derivatives along with gross external debt would imply that the foreign currency borrowing was only hedged when the forward contract was in a liability position, so creating a misleading impression. Thus, financial derivatives liability positions should be considered alongside financial derivatives asset positions. If an economy includes financial derivative reaches its settlement date, any unpaid overdue amount becomes debt, and thus is presented under other debt liabilities, short term.

<sup>&</sup>lt;sup>6</sup> If ESO data are unavailable, and it is unlikely that the amounts are significant, on de minimis grounds data should not be collected just to meet the requirements of this table.

	End period
Liabilities	
General Government	
Central Bank	
Deposit-Taking Corporations, except the Central Bank	
Other Sectors	
Other financial corporations	
Nonfinancial corporations	
Households and nonprofit institutions serving households (NPISHs)	
Assets <sup>1/</sup>	
General Government	
Central Bank	
Deposit-Taking Corporations, except the Central Bank	
Other Sectors	
Other financial corporations	
Nonfinancial corporations	
Households and nonprofit institutions serving households (NPISHs)	
Total Economy	

Table 4.4. Financial Derivatives and Employee Stock Options (ESOs) Positions with Nonresidents: By Sector

1/ Excludes financial derivatives that pertain to reserve asset management and are included in reserve asset data.

#### **Equity Liabilities**

4.16 Table 4.5 is a memorandum table for the presentation of position data on equity liabilities with nonresidents by sector—that is, equity (both equity shares and other equity) and investment fund shares, with direct investment positions separately identified. Similar to financial derivatives positions, equity can add to an economy's liabilities and so could potentially be a source of vulnerability.

4.17 In some instances, resident mutual funds are used as a vehicle by nonresident investors to acquire positions in domestic debt securities. If the nonresidents decide to sell these investments, the sales can have a direct impact on the domestic debt securities market. As explained in Chapter 3, such investments by nonresidents are classified as equity liabilities of the resident economy. Nonetheless, identifying equity investment in mutual funds, under nonbank financial corporations in the table, might be considered. Further, if the amounts are significant and concentrated in mutual funds that are entirely or almost entirely owned by nonresidents, memoranda data on the investments of these mutual funds might also be disseminated.

Table 4.5. Equity Liability Positions with Nonresidents: By Sector	
	End period
Deposit-Taking Corporations, except the Central Bank 1/	
Other Sectors 1/	
Other financial corporations	
Nonfinancial corporations	
Direct Investment: Equity and investment fund shares	
Total Economy	
1/ May include other equity liabilities ( <i>BPM6</i> , paragraph 5.26)	

#### **Resident-Issued Debt Securities Involved in Reverse Security Transactions**

4.18 In financial markets, activity in reverse security transactions is commonplace. It is one method of providing an investor with financial leverage in the debt markets—that is, greater exposure to market price movements than the value of own funds invested. To understand the dynamics of this leverage activity, and to track developments and hence potential vulnerability, a memorandum table is provided in Table 4.6 for the presentation of position data on debt securities issued by residents that are acquired from or provided to nonresidents under reverse security transactions (see paragraphs 3.36 and 3.37 for the recording treatment). Such data would also help to interpret external debt, in particular security debt data when reverse security activity is significant, and could be affecting the recorded position. For debt securities to be included in this memorandum table, the acquiring party (security taker) must have full title (legal ownership) to the debt securities such that they can be sold to a third party.

Table 4.6. Debt Securities Acc	wired Under Reverse Secu	rity Transactions 1/: 1	Positions
rubic noi Debe beeurittes nee	un cu onuci neverse secu	ity indistretions in the	osicions

	End period
Debt securities issued by residents and acquired by nonresidents from residents	ents (+)
Debt securities issued by residents and acquired by residents from nonresidents from	ents (–)
1/ Reverse security transactions include all arrangements whereby one part	y acquires
(security taker) debt securities and agrees, under a legal agreement at incept	tion, to
return the same or similar securities on or by an agreed date to the same par whom it acquired the debt securities initially (security provider). The securit	'ty from ty taker must
have full title to the debt securities such that they can be sold to a third party	7. These
arrangements can include those known as repurchase agreements (repos), se	ecurity
lending, and sell/buy backs.	

4.19 In the table, the total value of debt securities issued by residents that have been acquired by nonresidents from residents under outstanding reverse security transactions, even if subsequently on-sold, are included with a positive sign. The total value of debt securities issued by residents that have been acquired by residents from nonresidents under outstanding reverse security transactions, even if subsequently on-sold, are included with a negative sign. This sign convention tracks the change of legal ownership of debt securities. Other things being equal, if nonresidents acquire these securities under reverse security transactions, the external debt security claims on the resident economy are greater than those recorded in the gross external debt position, whereas if residents acquire these debt security claims on the resident economy are less than those recorded in the gross external debt position. Appendix II provides more information on reverse security transactions and explains how different types of reverse security transactions should also be recorded in the gross external debt position and in this memorandum table.

#### **Guaranteed External Debt Position**

4.20 The *Guide* encourages the measurement and monitoring of contingent liabilities, especially of guarantees, and outlines some measurement techniques (see Chapter 9). The magnitude of these "off-balance-sheet" obligations in recent financial crises reinforced the

need to monitor them. Consequently, a memorandum table for the presentation of position data on a narrow, albeit important, range of explicit contingent liabilities by sector of the guarantor is provided in Table 4.7. The memorandum table presents the value of guarantees of residents' external debt liabilities (liabilities of a unit of a resident sector, the servicing of which is contractually guaranteed by a unit of another sector resident in the same economy of the debtor)<sup>7</sup> and cross-border guarantees (debt of nonresidents to other nonresidents that is contractually guaranteed by a resident entity and debt of a legally dependent nonresident branch of a resident unit that is owed to a nonresident).<sup>8</sup> In both instances, the *Guide* recommends that the contingent external debt liability should be valued in terms of the maximum exposure loss (the full face value).

Table 4.7. Total Guaranteed External Debt Position: By Sector of the Guarantor 1/	
	End of Period
General Government	
Resident debtor 2/	
Nonresident debtor 3/	
Central Bank	
Resident debtor 2/	
Nonresident debtor 3/	
Deposit-Taking Corporations, except the Central Bank	
Resident debtor 2/	
Nonresident debtor 3/	
Other Sectors	
Resident debtor 2/	
Nonresident debtor 3/	
Other financial corporations	
Resident debtor 2/	
Nonresident debtor 3/	
Nonfinancial corporations	
Resident debtor 2/	
Nonresident debtor 3/	
Direct Investment: Intercompany Lending	
Nonresident debtor 3/	
Total Guaranteed External Debt Position	
1/ The full face value of guarantees of resident's external deb	t liabilities and cross-
border guarantees.	
2/ External debt liabilities of a unit of one resident sector, the	e servicing of which is
contractually guaranteed by a unit of another sector resident	in the same economy.

3/ Debt of nonresidents to other nonresidents that is guaranteed by a resident unit (inward risk transfer, column 2 in Table 9.3).

<sup>&</sup>lt;sup>7</sup> These liabilities are captured/covered in the gross external debt position as debt of the sector of the original debtor, whereas in this memorandum table they are presented as contingent liabilities (guarantees) of the sector of the guarantor.

<sup>&</sup>lt;sup>8</sup> Cross-border guarantees are included in Table 9.3, column 2, as inward risk transfer.

# 5. PUBLIC AND PUBLICLY GUARANTEED EXTERNAL DEBT

## A. Introduction

5.1 For countries in which the public sector is responsible for a large share of the external debt, it is particularly important to identify all the debt owed to nonresidents by this sector. This chapter provides a table for the presentation of the gross external debt position in which the role of the public sector is highlighted. The data for this table should be compiled using the concepts outlined in Chapters 2 and 3, except the debt of resident entities should be attributed according to whether the debtor is publicly owned or not, and if not, by whether the debt instrument is guaranteed or not by a public sector unit. For convenience, this presentation is described as being a "public-sector-based approach" and is consistent with the framework of the World Bank's Debtor Reporting System.

5.2 In economies where public sector external debt is dominant, the presentation tables provided in this chapter could be the primary ones used for disseminating data. Indeed, in circumstances where the public sector is centrally involved in external debt borrowing activity, both as a borrower or guarantor, these tables are essential. As private sector debt becomes more important in the economy, more detailed breakdowns of private sector debt are required, such as provided in the previous chapter, but the presentation set out in this chapter would remain relevant for monitoring external debt liabilities of the public sector.

5.3 Because the concepts and definitions for its measurement remain consistent throughout the *Guide*, the gross external debt position for the whole economy–depending on whether debt securities are valued at nominal or market value–should be the same regardless of whether the presentation tables in this or the previous chapter are used to disseminate such data.

5.4 In disseminating data, compilers are encouraged to provide methodological notes (metadata) explaining the concepts, definitions, and methods used in compiling the data. For any presentation of gross external debt position, it is particularly important for the compiler to indicate whether debt securities are valued at nominal or market value, and whether interest costs that have accrued but are not yet payable are included, or not.

## B. Definitions

5.5 For the presentation of the external debt position in a public-sector-based approach, the first determination is whether or not a resident unit is in the public sector.<sup>1</sup> In comparison with the institutional sector approach outlined in Chapter 3, the public sector comprises the

<sup>&</sup>lt;sup>1</sup> For more details, please refer to the World Bank's *Debtor Reporting System Manual* (World Bank, 2000), available at <u>http://siteresources.worldbank.org/DATASTATISTICS/Resources/drs\_manual.doc</u>.

general government, the central bank, and those units in the deposit-taking corporations, except central bank, and other sectors that are public corporations. A public corporation is defined as a nonfinancial or financial corporation that is subject to control by government units, with control over a corporation defined as the ability to determine general corporate policy.<sup>2</sup> Because the arrangements for the control of corporations can vary considerably, it is neither desirable nor feasible to prescribe a definitive list of factors to be taken into account. The following eight indicators, however, will normally be the most important factors to consider: (1) ownership of the majority of the voting power; (2) control of the board or other governing body; (3) control of the appointment and removal of key personnel; (4) control of key committees of the entity; (5) golden shares and options (golden shares give the holder a decisive vote, even without a majority of shares); (6) regulation and control; (7) control by a dominant customer; and (8) control attached to borrowing from the government. It may be possible to exercise control through special legislation, decree, or regulation that empowers the government to determine corporate policy or to appoint directors. Any domestic institutional unit not meeting the definition of public sector is to be classified as private sector. In terms of institutional sector attribution, the classification of a public corporation as a central bank, deposit-taking corporation, except the central bank, other financial corporation, or nonfinancial corporation depends on the nature of the activity it undertakes.

5.6 Publicly guaranteed private sector external debt is defined as the external debt liabilities of the private sector, the servicing of which is contractually guaranteed by a public unit resident in the same economy as the debtor.<sup>3</sup> The private sector can include resident units in the deposit-taking corporations, except the central bank, and other sectors. External debt of the private sector that is not contractually guaranteed by the public sector unit resident in the same economy is classified as private sector external debt not publicly guaranteed. If external debt of the private sector is partially guaranteed by the public sector unit resident in the same economy, such as if principal payments or interest payments alone are guaranteed, then only the present value of the payments guaranteed should be included within publicly guaranteed private sector external debt, with the nonguaranteed amount included within private sector external debt not publicly guaranteed.

#### C. Presentation of Public and Publicly Guaranteed External Debt Position

5.7 The presentation of the gross external debt position on the basis of a public-sectorbased approach is set out in Table 5.1.

• The first level of disaggregation is by sector. The primary disaggregation is between public and publicly guaranteed debt, and private sector external debt not publicly guaranteed. Because of the nature of the relationship between debtor and creditor, intercompany lending between entities in a direct investment relationship is separately

<sup>&</sup>lt;sup>2</sup> "General corporate policy" refers to, in a broad sense, the key financial and operating policies relating to the corporation's strategy objectives as market producer. See *2008 SNA*, paragraphs 4.77-4.80 for more details. For a definition of control of a corporation by a government unit, see *Public Sector Debt Statistics: Guide for Compilers and Users* (2011), paragraph 2.17.

<sup>&</sup>lt;sup>3</sup> External debt for which guarantees are provided to the creditor by a public sector unit resident in a different economy from that of the debtor is not covered under this definition.

identified under each category, but when combined equals direct investment: intercompany lending for the total economy as presented in the previous chapter.

- The second level of disaggregation is by the maturity of external debt-short-term and long-term on the basis of original maturity. A maturity attribution is not provided for intercompany lending.<sup>4</sup>
- The third level of disaggregation is by type of debt instrument, as described in Chapter 3.

5.8 Total value of arrears and debt securities by sector are separately identified in memorandum items to Table 5.1. Arrears are recorded in the original instrument until the liability is extinguished, and are presented in nominal value in the memorandum items because such information is of particular analytical interest. This *Guide* recommends that both nominal and market values be provided for debt securities (see paragraph 2.33). For this purpose, in memorandum items to Table 5.1, debt securities are valued either at nominal value if they are presented at market value in the table, or at market value if they are presented at nominal value in the table.

5.9 Memoranda data series on a public sector basis on arrears, external debt by short-term remaining maturity, financial derivatives and ESOs, equity liabilities, debt securities acquired under reverse security transactions, and guaranteed external debt position could be provided along with Table 5.1. These memorandum tables are described in Chapter 4.

<sup>&</sup>lt;sup>4</sup> If a short-/long-term maturity attribution of intercompany lending data is available to the compiler on an original maturity basis, the *Guide* encourages dissemination of these data.

	End Period
Public and Publicly-Guaranteed External Debt	
Short-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term	
Special drawing rights (SDRs), Allocation	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Direct investment: Intercompany lending	
Dabt liabilities of direct investment enterprices to direct investors	
Debt liabilities of direct investment enterprises to direct investors	
Debt habilities of direct investors to direct investment enterprises	
Debt habilities between fellow enterprises	
Private Sector External Debt Not Publicly Guaranteed	
Short-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Direct investment: Intercompany lending	
Debt liabilities of direct investment enterprises to direct investors	
Debt liabilities of direct investors to direct investment enterprises	
Debt liabilities between fellow enterprises	
Gross External Debt Position	
M	
Memorandum Items	
Arrears 3/	
Public and Publicly-Guaranteed External Debt	
Private Sector External Debt Not Publiciy Guaranteed	
Debt securities 4/	
Public and Publicly-Guaranteed External Debt	
Short-term	
Long-term	
Private Sector External Debt Not Publicly Guaranteed	
Short-term	
Long-term	
1/ It is recommended that all currency and deposits be included in the short-term cat detailed information is available to make the short-term/long-term attribution.	egory unless
2/ Other debt liabilities comprise insurance, pension, and standarized guarantee sche accounts payable-other in the IIP statement.	mes, and other
	• • •

3/ Arrears are recorded in the original debt instrument rather than in other debt liabilities, short term.
4/ Debt securities valued at market value if they are presented at nominal value in the table, or at nominal value if they are presented at market value in the table. Debt securities in the memoradum items do not include those that may be included in Direct investment: Intercompany Lending.

5.10 Table 5.2 separates public sector external debt and publicly guaranteed private sector external debt. Such a separation allows identification of external debt owed by the public sector and--combined with the information on private sector debt not publicly guaranteed in Table 5.1--external debt of the private sector. Table 5.2 presents the same levels of

disaggregation (by sector, original maturity, and type of debt instrument) and memorandum items as Table 5.1.

Table 5.2. Gross External Debt Position: Public Sector Debt and Publicly-Guaranteed Pr	ivate Sector Debt
	End Period
Public Sector External Debt	
Short-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term	
Special drawing rights (SDRs), Allocation	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Direct investment: Intercompany lending	
Debt liabilities of direct investment enterprises to direct investors	
Debt liabilities of direct investors to direct investment enterprises	
Debt liabilities between fellow enterprises	
Publicly-Guaranteed Private Sector External Debt	
Short-term	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities $2/3/$	
Long-term	
Currency and denosite 1/	
Debt securities	
Loans	
Trade gradit and advances	
Other deltalia auvalices	
Direct investment. Intercomment lending	
Direct investment: Intercompany lending	
Debt liabilities of direct investment enterprises to direct investors	
Debt liabilities of direct investors to direct investment enterprises	
Debt liabilities between fellow enterprises	
Total	
Memorandum Items	
Arrears 3/	
Public Sector External Debt	
Publicly-Guaranteed Private Sector External Debt	
Debt securities 4/	
Public Sector External Debt	
Short-term	
Long-term	
Publicly-Guaranteed Private Sector External Debt	
Short-term	
Long-term	
1 / It is recommended that all surrongy and denosite he included in the short term setere	ryuploss
11/ It is recommended that an currency and deposits be included in the short-term catego	iy umess

1/ It is recommended that all currency and deposits be included in the short-term category unless detailed information is available to make the short-term/long-term attribution.

2/ Other debt liabilities comprise insurance, pension, and standarized guarantee schemes, and other accounts payable-other in the IIP statement.

3/ Arrears are recorded in the original debt instrument rather than in other debt liabilities, short term.

4/ Debt securities valued at market value if they are presented at nominal value in the table, or at nominal value if they are presented at market value in the table. Debt securities in the memoradum items do not include those that may be included in Direct investment: Intercompany Lending.

Table 5.3 presents the gross external debt position separately identifying the public 5.11 sector debt, publicly guaranteed private sector debt, and private sector debt not publicly guaranteed broken down by original maturity (short-term and long-term). The nominal value of arrears by sector is separately identified in the memorandum item to Table 5.3.

Table 5.3. Gross External Debt Position: Public Sector Debt, Publicly-Guaranteed Debt, and Private	
Sector Debt Not Publicly Guaranteed	
	End Period
Public Sector External Debt 1/	
Short-term 2/3/	
Long-term	
Publicly-Guaranteed Private Sector External Debt 1/	
Short-term 2/3/	
Long-term	
Private Sector External Debt Not Publicly Guaranteed 1/	
Short-term 2/3/	
Long-term	
Gross External Debt Position	
Memorandum Items	
Arrears 4/	
Public Sector External Debt	
Publicly-Guaranteed Private Sector External Debt	
Private Sector External Debt Not Publicly Guaranteed	
1/ Includes direct investment: intercompany lending liabilities.	
2./ It is recommended that all currency and deposits be included in the shor	t-term category unless

Table 5.3. Gross External Debt Position: Public Sector Debt, Publicly-Guaranteed De	ebt, and Private
Sector Debt Not Publicly Guaranteed	

detailed information is available to make the short-term/long-term attribution.

3/ Arrears are recorded in the original debt instrument rather than in other debt liabilities, short term.

Further, as defined in paragraphs 5.5 and 5.6 above, public sector data can be 5.12 attributed to general government, central bank, depositary-taking corporations, except the central bank, and other sectors, while private sector information can be attributed to deposittaking corporations, except the central bank and other sectors. In this regard, it is recommended that if detailed records are kept, the institutional sector of the debtor be identified, so as to allow an economy that is presenting data on a public sector basis to also compile data on an institutional sector basis.
# 6. FURTHER EXTERNAL DEBT ACCOUNTING PRINCIPLES

# A. Introduction

6.1 Data compiled and presented using the concepts and definitions described in the previous chapters provide comprehensive coverage and an informed picture of the gross external debt position for the whole economy and/or the public sector. However, such data do not provide a complete picture of emerging vulnerabilities to solvency and liquidity risk. For instance, the currency and interest rate composition of external debt liabilities, and the pattern of future payments, might all be potential sources of vulnerability. To assist in compiling additional data series of analytical use in understanding the gross external debt position, this chapter provides further accounting principles. These principles, as well as those described in earlier chapters, are drawn upon to provide illustrative presentation tables in the next chapter.

6.2 This chapter discusses further accounting principles under three broad headings:

- Sectors, maturity, and instruments;
- Specific characteristics of external debt; and
- Principles for the compilation of debt-service and other payment schedules.

## **B.** Sectors, Maturity, and Instruments

## **Creditor Sectors**

6.3 Information on the nonresident creditor sector that owns external debt is disseminated by many economies. The sectors defined in Chapter 3–general government, central bank, deposit-taking corporations, except the central bank, and other sectors–and in Chapter 5public and private sectors–are creditor as well as debtor sectors. Other commonly identified creditor sectors are multilateral (international) organizations<sup>1</sup> and official creditors.

6.4 Multilateral organizations are entities established by political agreements among member countries that have the status of international treaties. Multilateral organizations are accorded appropriate privileges and immunities and are generally not subject to, or are only partially subject to the laws and regulations of the economies in which the organizations are located. Typically these organizations provide nonmarket services of a collective nature for the benefit of members and/or financial intermediation at an international level; that is, the channeling of funds between lenders and borrowers in different economies. As creditors, multilateral organizations are sometimes also referred to as official multilateral creditors.

<sup>&</sup>lt;sup>1</sup> Multilateral organizations are referred to as international organizations in *BPM6* (see paragraphs 4.103 - 4.107).

6.5 Official creditors are public sector creditors, including multilateral organizations. External debt owed to official creditors might also include debt that was originally owed to private creditors but that was guaranteed by a public entity in the same economy as the creditor (for example, an export credit agency). Official bilateral creditors are official creditors in individual countries. This category of creditor is particularly relevant in the context of Paris Club discussions. The Paris Club is an informal group of official bilateral creditors, which seeks to find coordinated and sustainable solutions to external public debt payment difficulties facing some of its debtors. It provides debt relief treatments to debtor countries through debt flow rescheduling and/or stock operations. It is not a formal institution and it does not have a legal status (see Box 8.2 in Chapter 8).

## **Remaining Maturity**

6.6 While it is recommended that in the gross external debt position the short-term/longterm maturity attribution be made on the basis of original maturity (that is, the period of time from when the liability was created to its final maturity date), there is also analytical interest in attribution on the basis of remaining maturity (that is, the period of time from the reference date until the debt payments fall due).<sup>2</sup> Remaining-maturity measures (sometimes referred to as residual-maturity measures) provide an indication of when payments will fall due, and so of potential liquidity risks facing the economy. Particularly important is information on payments coming due in the near term.

6.7 The *Guide* recommends that short-term remaining maturity be measured by adding the value of outstanding short-term external debt (original maturity) to the value of outstanding long-term external debt (original maturity) due to be paid in one year or less. Conceptually, at the reference date the value of outstanding long-term external debt (original maturity) due to be paid in one year or less is the discounted value of payments to be made in the coming year, both interest and principal.<sup>3</sup> The value of outstanding long-term (original maturity) debt due to be paid over one-year ahead is classified as long-term debt on a remaining-maturity basis.

6.8 The information content provided is one reason for recommending such an approach. Short-term debt on an original maturity basis is identifiable from the gross external debt position. Measuring the value of outstanding long-term external debt (original maturity) falling due in one year or less may raise practical difficulties, in which instance, one proxy measure that might be used is the undiscounted value of principal payments on long-term external debt obligations (original maturity basis) due to mature in one year or less. This proxy measure is incomplete in its coverage of interest payments falling due in the coming

<sup>&</sup>lt;sup>2</sup> For practical reasons, the maturity date of the debt instrument may be used as a proxy.

<sup>&</sup>lt;sup>3</sup> For those economies that do not wish to include interest costs that have accrued but are not yet payable in the gross external debt position for all instruments, the nominal value of outstanding long-term external debt at the reference date that is due to be paid in one year or less is the sum of principal payments on this debt to be made in the coming year, except where the debt is in the form of securities issued at a discount, in which instance the principal amount to be paid will exceed the nominal amount outstanding at the reference date.

year but can be compiled using the principles for projecting payments in a debt-service schedule (see below).<sup>4</sup>

## **Trade-Related Credit**

6.9 In the *Guide*, trade credit and advances as presented in the gross external debt position is defined in Chapter 3—the direct extension of credit by suppliers of goods and services to their customers, and advances for work that is in progress (or is yet to be undertaken) and prepayment by customers for goods and services not yet provided—consistent with the 2008 SNA and BPM6. To assist in compiling additional data series, this chapter introduces a wider concept of trade-related credit, which also captures other credits provided to finance trade activity, including through banks. It is defined as including trade credit and advances, trade-related bills (see below), and credit provided by third parties to finance trade, such as loans from a foreign financial or export credit institution to the buyer. A table for presenting data on trade-related credit is provided in the next chapter.

6.10 A particularly difficult issue of classification arises from trade bills drawn on the importer and provided to the exporter, which are subsequently discounted by the exporter with a financial institution. These instruments might be regarded by the importer as the direct extension of credit by the exporter but once discounted become a claim by a third party on the importer. Where an instrument is provided to the exporter with such characteristics that it is negotiable in organized and other financial markets, such as a promissory note, it should be classified as a security in the gross external debt position and included in the concept of trade-related credit. In principle, a supplier may also sell trade claims other than trade bills to a factoring company, in which instance the claim is reclassified from trade credit and advances to other debt liabilities (other accounts payable-other) in the gross external debt position, and included in the concept of trade-related credit.

6.11 If the importer's bill has been endorsed (or "accepted") by a bank in the importer's own economy in order to make the bill acceptable to the exporter, it is known as a bankers' acceptance, classified as a security in the gross external debt position, and included in the concept of trade-related credit. Bankers' acceptances are to be classified as a financial liability of the bank (or, if not a bank, the financial institution that has endorsed the bill) because they represent an unconditional claim on the part of the holder and an unconditional claim on the bank. However, national practices and variations in the nature of these acceptances may suggest flexibility in the application of this guideline.

<sup>&</sup>lt;sup>4</sup> Some countries that have debt primarily in the form of instruments on which principal is paid only at maturity attribute the full value of each long-term (original maturity) debt instrument on a remaining basis by when the instrument is due to mature. However, from the viewpoint of liquidity risk analysis, this method is imperfect because payments coming due in the near term, such as interest and partial payments of principal, are not captured within short-term remaining-maturity debt if the debt instrument has a maturity date further than a year ahead.

#### **Box 6.1 Trade-Related Credit**

In analyzing activity in international trade in goods and services, information on trade-related credit is essential. Past evidence has demonstrated that trade patterns can be severely disrupted by changes in the provision of trade-related credits. Assessment of conditions of trade finance is complicated by the absence of organized markets and the proprietary nature of customer relationships. Against this background, the IMF has launched a trade finance survey covering major banking institutions.

**Trade finance:** Trade finance covers a spectrum of payments arrangements between importers and exporters: *open-account financing* allows importers to repay exporters directly after receipt of goods; *bank-intermediated trade finance* which allows importers or exporters to shift some of the nonpayment or nonperformance risk to banks (e.g., by issuing or confirming the letter of credit) or to obtain bank financing to allow the exporter to receive payment before importer is required to make it; and *cash-in-advance arrangements* are where importers pay for goods before they are shipped. Members of Berne Union (BU), such as export credit agencies and private export credit insurers, also participate in trade finance markets in a manner similar to commercial banks.

Multilateral development bank programs also play a role by providing a secondary guarantee or liquidity to banks. *Trade credit and advances* in the *Guide* and *BPM6* refer to open-account financing and cash-in-advance

#### Figure. Trade Finance Arrangements

		Open Account						
Cash in Advance	Bank Trade Finance	(38% - 45%, \$6.0 - \$7.2 trillion)						
19%-22% \$3 - \$3.5 trillion	35%-40% \$5.5-\$6.4 trillion	Credit Covered by BU members \$1.25-1.5 trillion	Arm's-Length Non-Guaranteed	Intra-Firm				

\$15.9 trillion in global merchandise trade (2008 IMF estimate)

Source: IMF Staff estimates, IMF-BAFT Surveys of commercial banks, and Berne Union (BU) data.

arrangements. Trade-related lending by banks is included under loans and other off-balance sheet items that do not give rise to financial assets (e.g., letters of credit, see *BPM6*, paragraphs 5.9 and 5.13).

**Survey design:** The design of the initial survey benefited from inputs from the European Bank for Reconstruction and Development (EBRD) and Hong Kong and Shanghai Banking Corporation (HSBC). The second survey benefited from inputs from a cosponsor, the Bankers' Association for Finance and Trade, now merged with International Financial Services Association (BAFT-IFSA). The third survey benefited from inputs from the Banking Commission of the International Chamber of Commerce (ICC), which has been building an expertise by conducting its own survey <u>ICC</u>

Table. Basi	ic Information	n on Trade Financ	ce Survey
Survey Period	Period	Repondents	Countries
in Field	Through	(number)	(number)
1	Dec-08	40	n.a.
2	Mar-09	44	23
3	Jul-09	88	44
4	Mar-10	93	53
5	Dec-10	118	34
6	Aug-11	63	n.a.
7	Dec-11	337	91

<u>Global Survey on Trade Finance</u> annually since 2009. The design of the fifth survey benefited from the IMF survey experts in Technology and General Services Department. The seventh survey, a collaboration with ICC, <u>ICC-IMF Market Snapshot January 2012</u> was made substantially shorter, both in length and during in the field, to swiftly assess the rapidly changing market sentiment of the last quarter of 2011.

**Implementation:** The surveys were distributed primarily to membership of BAFT-IFSA, the Latin American Federation of Banks (FELEBAN), and ICC and also to others that International Financial Institutions and private entities were able to reach out. In particular, the EBRD, the Asian Development Bank, the Inter-American Development Bank, the African Development Bank, and the International Finance Corporation provided valuable assistance in distributing surveys to relevant financial institutions. The number of respondents varied significantly, depending on the methods used to collect the data and to reach out to respondents, as well as the length and complexity of the surveys.

**Content:** In each of the surveys, except for the seventh survey, banks were asked: (a) to compare the state of their trade finance business across different time periods, including volumes, prices, and relative default probabilities; (b) to assess the impact of banking regulatory changes (in particular Basel II and III); and (c) to share their expectations about likely near-term industry developments (as with many such surveys, there is the risk of bias coming from self-selection). The results of the first four surveys are discussed in <u>Trade and Trade</u> <u>Finance in the 2008-09 Financial Crisis</u> (IMF working paper WP/11/16).

## C. Specific Characteristics of External Debt

## **Currency Composition**

6.12 Domestic currency is that which is legal tender in the economy and issued by the monetary authority for that economy or for the common currency area to which the economy belongs.<sup>5</sup> All other currencies are foreign currencies. Under this definition, an economy that uses as its legal tender a currency issued by a monetary authority of another economy—such as U.S. dollars—or of a common currency area to which it does not belong should classify the currency as a foreign currency, although domestic transactions are settled in this currency. SDRs are considered to be foreign currency in all cases, including for the economies that issue the currencies included in the SDR basket.

6.13 The attribution of external debt by currency is primarily determined by the currency of denomination<sup>6</sup>. Foreign currency debt is defined as debt in which the value of flows and positions is fixed in a currency other than the domestic currency. Accordingly, all cash flows are determined using the currency of denomination and, if necessary, converted into the domestic currency or another unit of account for the purpose of settlement or compilation of accounts. A subcategory of foreign currency debt is debt that is settled in a foreign currency but with the amounts to be paid linked to a domestic currency (domestic-currency-linked debt). Foreign-currency-linked debt is debt that is settled in domestic currency but with the amounts to be paid linked to a foreign currency. Foreign-currency-linked debt is classified and treated in the international accounts as being denominated in foreign currency. Domestic currency debt is debt that is payable in the domestic currency, and not linked to a foreign currency. In the unusual instance of interest payments being denominated in a foreign currency but principal payments are denominated in a domestic currency, or vice versa, only the present value of the payments denominated in a foreign currency need be classified as foreign currency debt (and similarly for foreign-currency-linked debt). Unallocated gold accounts and other unallocated accounts in other precious metals giving title to claim the delivery of gold or precious metal are treated as debt denominated in foreign currency.

6.14 In attributing external debt by type of foreign currency–U.S. dollar, euro, Japanese yen, etc.–the currency in which payments are denominated is the determining criterion. Some types of foreign currency borrowing are denominated in more than one currency. However, if the amounts to be paid on such borrowing are linked to one specific currency, the borrowing should be attributed to that currency. Otherwise, compilers are encouraged to disaggregate such multicurrency borrowing by the component currencies. If, for any reason at the time the

<sup>&</sup>lt;sup>5</sup> In this context, a common currency area is one in which more than one economy belongs and has a regional central bank with the legal authority to issue the same currency within the area. To belong to this area, the economy must be a member of the regional central bank.

<sup>&</sup>lt;sup>6</sup> The currency of denomination is determined by the currency in which the value of flows and positions is fixed as specified in the contract or other agreement between the parties; it is important for distinguishing transaction values and holdings gains and losses. The currency of settlement may be different from the currency of denomination. Using a currency in settlement that is different from the currency of denomination simply means that a currency conversion is involved each time a settlement occurs. (*BPM6*, paragraphs 3.98-3.104).

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data are compiled for a particular reference date, the amounts attributable to each currency at that date are not known with precision, the borrowing should be attributed to each type of currency using the latest firm information available to the compiler-such as the currency attribution at the previous reference date together with any known payments in specific currencies made during the subsequent period-and revised once firm information for the new reference date are known.

#### **Interest Rates**

#### Variable- and fixed-rate external debt

6.15 Variable-rate external debt instruments are those on which interest costs are linked to a reference index—for example, LIBOR (London interbank offered rate), 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. All other debt instruments should be classified as fixed-rate. Interest on external debt that is linked to the credit rating of another borrower should be classified as fixed-rate because credit ratings do not change in a continuous manner in response to market pressures, whereas interest on external debt that is linked to a reference price index should be classified as variable-rate, provided that the price(s) that are the basis for the reference index are primarily market-determined.

6.16 The classification of an instrument can change over time, if, say, it switches from fixed to variable rate. For instance, interest may be fixed for a certain number of years and then becomes variable. While a fixed rate is paid, the instrument is to be classified as fixed-rate debt, and when it switches to variable rate it is classified as variable-rate debt.<sup>7</sup> If interest is linked to a reference index or commodity price or financial instrument price but is fixed unless the reference index or price passes a particular threshold, it should be regarded as fixed-rate. However, if thereafter interest becomes variable, then it should be reclassified as a variable-rate instrument. Alternatively, if interest is variable-rate until it reaches a predetermined ceiling or floor, it becomes fixed-rate debt when it reaches that ceiling or floor.

6.17 Index-linked debt instruments are classified as being variable-rate<sup>8</sup>. For these instruments, the principal or coupons, or both are indexed to some variable; for example, to a general or specific price index. Because index-linked instruments have variable aspects, a debt instrument is classified as variable-rate if the indexation applies to the principal or coupons, or both (notwithstanding the treatment of interest<sup>9</sup>).Therefore, if principal only is

<sup>&</sup>lt;sup>7</sup> For vulnerability analysis purposes, it is common practice to treat instruments that switch from fixed to variable rate as variable-rate debt. For debt whose interest can switch from fixed to variable rate, where significant, compilers could provide additional information in notes to the corresponding classification tables.

<sup>&</sup>lt;sup>8</sup> Nevertheless, foreign-currency-linked instruments are treated as being denominated in the foreign currency (see paragraph 6.13), rather than indexed to it.

<sup>&</sup>lt;sup>9</sup> Two approaches that can be followed to determine the interest accrual in each accounting period when the amount to be paid at maturity is index-linked, are discussed in *BPM6*, paragraphs 11.59–11.65.

indexed, such debt is to be classified as variable-rate regardless of whether interest is fixed or variable provided that the reference index meets the criterion above; that is, it normally changes over time in a continuous manner in response to market pressures.

#### Average interest rates

6.18 The average interest rate is the weighted-average level of interest rates on the outstanding gross external debt as at the reference date. The weights to be used are determined by the value in the unit of account of each borrowing as a percentage of the total. For example, for the general government sector the weight given to the interest rate on each external debt instrument equals the value in the unit of account of that debt as a percentage of total external debt for the general government sector. Similarly, the weight given to the average level of interest rates for the general government sector when calculating the average interest rate for the whole economy is equal to the total value in the unit of account of general government external debt.

6.19 The relevant interest rate level for each debt instrument is affected by whether it has a fixed- or variable-linked interest rate. If the interest rate is contractually fixed, then this rate should be used, taking account of any discount and premium at issuance. If the rate of interest had been variable in the past but is now fixed, the current fixed-rate should be used. For variable-rate instruments, the rate of interest on each instrument should be the rate accruing on the reference day. In other words, usually variable rates of interest are reset on a periodic basis, and it is the level of the interest rate applicable on the reference day that should be used. If the interest rate is reset on the reference date, that rate should be reported and not the previous interest rate. If for any reason the variable rate is not observable, then the level of the reference index or appropriate price on the reference date, or, if the link is to a change in the reference index, the recorded change for the relevant period up to the reference date, or the closest relevant time period available, together with any existing additional margin the borrower needs to pay, should be used to calculate the interest rate level.

6.20 For calculating the weighted average of interest rates agreed on new borrowing during the period, the interest rates recorded would be those established at the time of the borrowing. If the interest rate is contractually fixed, then this rate should be used. For variable-rate borrowing, the rate of interest on each instrument should be that which is accruing on the day the claim is established. The weights to be used in compiling average interest rate data are determined by the value in the unit of account of each borrowing, on the date the claim was established, as a percentage of the total borrowed during the period.

## Location of Securities Issuance

6.21 Debt securities issued by a resident of the same economy in which the security is issued are to be classified as domestically issued, regardless of the currency of issue.<sup>10</sup> All other issues are to be classified as internationally issued. If there is uncertainty over the

<sup>&</sup>lt;sup>10</sup> Regardless of location of issue, any security owned by nonresidents and issued by residents of a given economy is to be classified as part of the external debt of that economy.

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location of issue, then the following criteria should be taken into account in descending order of preference to determine whether a resident of the economy has issued a domestic or an international debt security:

- The debt security is listed on a recognized exchange in the domestic economy (domestic issue) or in a foreign economy (international security).
- The debt security has an International Security Identification Number (ISIN) with a country code the same as the legal domicile of the issuer, and/or is allocated a domestic security code by the domestic national numbering agency (domestic security). Or the debt security has an ISIN code with a country code different from that where the issuer is legally domiciled and/or has a foreign security code issued by a foreign national numbering agency (international security).
- The security is issued in a domestic currency (domestic issue), as defined in paragraph 6.12 above, or in a foreign currency (international issue).

## **Concessional Debt**

6.22 There is no unique definition of concessionality, and the Guide does not provide nor recommend one. Nevertheless, it is generally accepted that concessional loans occur when units lend to other units at a contractual interest rate intentionally set below the market interest rate that would otherwise apply. Concessionality does not only relate to interest rates below market, but to the whole package of concessional terms to the borrowing unit including maturity and subsidies from third parties. The degree of concessionality can be enhanced with grace periods and frequencies of payments and maturity periods favorable to the debtor. The definition of the OECD's Development Assistance Committee  $(DAC)^{11}$  is commonly used. Under the DAC definition, concessional lending (that is, lending extended on terms that are substantially more generous than market terms) includes (1) official credits with an original grant element of 25 percent or more using a 10 percent rate of discount (that is, where the excess of the face value of a loan from the official sector over the sum of the discounted future debt-service payments to be made by the debtor is 25 percent or more using a 10 percent rate of discount); and (2) lending by the soft window of the World Bank and major regional development banks, and from the IMF.

6.23 The IMF uses a methodology for calculating loan concessionality in which the discount rates used are computed in a manner that is closely aligned with the methodology employed in the OECD's Arrangement on Officially Supported Export Credits. Specifically, a debt is concessional if it includes a grant element of at least 35 percent (or more in certain cases), calculated as follows: the grant element of a debt is the difference between the present value of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The present value of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the OECD.

<sup>&</sup>lt;sup>11</sup> The Development Assistance Committee of the OECD was created in 1960. Its membership at end-2010 comprised 23 countries and the Commission of the European Union.

6.24 All external debt not classified as concessional should be classified as nonconcessional.

## D. Debt-Service and Other Payment Schedules

6.25 A payment schedule provides a projection of future payments, at a reference date, based on a certain set of assumptions that are likely to change over time. A debt-service payment schedule projects payments on the outstanding gross external debt position at the reference date and helps in the assessment of liquidity risk by allowing the data user, and debtor, to monitor whether a bunching of payments is developing regardless of the original maturity of the debt instrument. For the debtor, early warning of such bunching might allow countervailing action to be taken.

6.26 Because the projection of a payment schedule requires assumptions to be made, to assist compilers, some guidance is provided below on the assumptions to apply. In compiling payment schedules, the *Guide* encourages the compiler to make best efforts in projecting payments. Consistent with the definitions in paragraph 2.5, in the debt-service payment schedule, interest payments are periodic payments of interest costs, while principal payments are all other payments that reduce the principal amount outstanding.

## **Projected Payments of Foreign Currency External Debt**

6.27 External debt payments may be required in a currency different from the unit of account used for presenting data in the debt-service payment schedule. For such external debt payments, projected payments should be converted to the unit of account using the market exchange rate (that is, the midpoint between the buying and the selling spot rates) prevailing on the reference date (that is, the last day before the start of the forward-looking period). In other words, if a debt-service payment schedule is drawn up for external debt outstanding on an end-calendar-year reference date, then the exchange rate prevailing at the end of the calendar year (on the last day of that year) should be used.<sup>12</sup>

6.28 For borrowing in multicurrencies, payments should be projected with reference to the component currencies of the borrowing and to the market exchange rates (the midpoint between the buying and the selling spot rates) prevailing on the reference date. For World Bank currency pool loans, future payments should be projected in U.S. dollar equivalent

<sup>&</sup>lt;sup>12</sup> From a theoretical viewpoint, and given that the debt-service payment schedule is making projections, forward rates may be considered the best estimate of exchange rates for specific dates in the future. However, while such an approach might well be readily applied in many instances for shorter-term debt in major currencies, there may be a lack of readily observable forward rates for longer-term borrowing and for "smaller" currencies, thus leading to possible inconsistent approaches between economies and different maturity periods. Also, there always remains uncertainty about the future course of interest and currency rates. The *Guide* takes the view that projections of future payments of external debt linked to currency and interest rate movements should be based on end-period spot rates, rather than, say, forward rates, because this approach is more transparent, easier to compile, and more readily understandable to users than projections based on rates in forward markets-even though it is recognized that the use of a single day's exchange rate to convert payments to be made over a forward period could be misleading if temporary factors affect the exchange rate for that day.

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terms on the basis of the pool units to be "paid" on each due date and the pool unit value at the reference date, and then converted into the unit of account, if this is not the U.S. dollar,<sup>13</sup> at the market exchange rate (the midpoint between the buying and the selling spot rates) prevailing on the reference date.

#### **Receiving or Paying Foreign Currency Under a Financial Derivatives Contract**

6.29 Consistent with the foreign-currency-conversion approach adopted throughout the *Guide*, the amounts of foreign currency contracted to be paid and received under a financial derivatives contract that is current and outstanding at the reference date should be converted to the unit of account using the market exchange rate (the midpoint between the buying and the selling spot rates) prevailing on the reference date (the last day before the start of the forward looking period).

## **Projected Interest Payments on Deposits**

6.30 Interest on deposits that is payable once a year or more frequently is projected as a future interest payment. Interest payments on deposits should be projected on the basis of those deposits that are outstanding on the reference date, using interest rates current on the reference date, unless there are contractual reasons to assume otherwise.

6.31 Interest on deposits that are withdrawable on demand or subject to a notice of withdrawal, and not subject to a maturity date, should be projected into the future,<sup>14</sup> whereas those interest payments on those deposits with a maturity date should be projected only to that maturity date. Payments on deposits for which notice of withdrawal has been given should be projected on the assumption that these deposits will be withdrawn on the due date, and no assumption of reinvestment should be made unless there are explicit instructions from the depositor that indicate otherwise.

## Projected Payments of Index-Linked External Debt, Including Variable-Rate Interest

6.32 Interest and principal payments on external debt may be linked to a reference index that changes over time-for instance, a variable reference interest rate index, a commodity price, or another specified price index. For such payments, projected payments should be estimated using the level of the reference index on the last day before the start of the forward-looking period or, if the link is to a change in the reference index, the recorded change for the relevant period up to the last day before the start of the forward-looking

<sup>&</sup>lt;sup>13</sup> Currency pool loans are loans that are committed in U.S. dollar equivalent terms and converted into pool units, the base unit the borrower owes, through a conversion rate-pool unit value-that is calculated on the basis of the relationship between the U.S. dollar and the component currencies in the pool. When pool units are to be repaid, they are converted back into the dollar-equivalent amount using the prevailing pool unit value. Currency pool loans are described in more detail in Appendix I.

<sup>&</sup>lt;sup>14</sup> In principle, the future could be indefinite, but compilers are encouraged to make some commonsense assumptions about the average maturity of deposits with no stated maturity.

period, or the closest relevant time period available.<sup>15</sup> If the margin over the reference index is subject to change, then the margin on the last day before the start of the forward-looking period should be used. For debt payable in commodities or other goods, future payments are valued using the market price of a commodity or good as at the reference date, with the split between principal and interest payments based on the implicit interest rate at the reference date (see also paragraph 2.43).

#### **Projected Payments on Loans Not Fully Disbursed**

6.33 No payments should be projected for loans that are not yet disbursed. If loans have been partially disbursed, payments should be projected only for those funds that have been disbursed. If the payment schedule in the loan contract is based on the assumption that all funds are disbursed, but only partial disbursement has occurred by the reference date, then, in the absence of any other information that clearly specifies the payment schedule arising from funds that have been disbursed, it is recommended that the payment schedule in the loan contract should be prorated by the percentage of the loan that has been disbursed-for example, if half of the loan has been disbursed, then half of each payment in the loan schedule should be reported in the debt-service schedule.<sup>16</sup>

#### **Projected Payments of Service-Related Debts**

6.34 In the *Guide*, if a payment to a nonresident for a service that has been provided is outstanding at the reference date, it is classified as an external debt liability.<sup>17</sup> Given this, any future payments for services-related debt—such as fees, charges, and commissions that have already been provided by the reference date but not yet paid—are classified as principal payments, within trade credit and advances (unless they are classified as debt liabilities to direct investment enterprises/direct investors/fellow enterprises, in direct investment: intercompany lending). Any projection of fees that depend on moving reference amounts, such as undrawn commitments, should be based on the reference amount at the reference date. While not encouraged, it is recognized that national practice might be to classify service charges related to a loan along with interest in the debt-service schedule.<sup>18</sup>

#### Projected Payments of External Debt with the Provision for Early Repayment

<sup>&</sup>lt;sup>15</sup> Like in the case of projected payments of foreign currency external debt, the *Guide* takes the view that projections of future payments of index-linked external debt should be based on end-period spot reference indexes, rather than, say, forward reference indexes (see footnote 12 above).

<sup>&</sup>lt;sup>16</sup> For prudent debt-management purposes, in some national practices, even if only partially disbursed, the full amounts foreseen in the payment schedule of the loan are projected for each period until the external debt outstanding at the reference date is fully repaid. Under this "truncated" approach, if half the amount is disbursed on the reference date, the loan is "repaid" in half the time that is expected in the loan schedule, thus "front-loading" the debt-service schedule.

<sup>&</sup>lt;sup>17</sup> The provision of services should be recorded on an accrual basis in each accounting period (i.e., they should be recorded as they are rendered, not when payments are made—see *BPM6*, paragraph 3.47). When a service is rendered, a debt liability is created and exists until payment is made (see paragraph 2.27).

<sup>&</sup>lt;sup>18</sup> As discussed in chapter 2, the *Guide* recommends that FISIM when applicable is to be included with interest in the debt-service payment schedule.

6.35 An external debt liability may include a provision that allows the creditor to request early repayment. For instance, the creditor may have an option to redeem the debt early through a put (sell) option. In principle, projected payments can be estimated both without and with reference to this embedded put option. For instance, a ten-year bond with a put option after five years can be assumed at inception to have a repayment date of ten years, and payments recorded up until that date. Alternatively, for this bond the earliest possible date for repayment of five years could be assumed, with projected payments finishing at that time. The preference in the *Guide* is to project debt-service payments on the basis of the original maturity (ten years in the example), but to provide additional information on payments based on the earliest repayment date (five years in the example). But it is recognized that national practice may be to estimate projected payments on bonds with embedded put options only until the option date (five years in the example), with additional information on the projected payments on the bond up until the original maturity date (ten years in the example).

## **Projected Payments of Credit-Linked External Debt**

6.36 Payments of interest and/or principal may be linked to the credit rating of another borrower(s), such as in a credit-linked note. In these instances, the credit rating of the other borrower(s) on the last day before the start of the forward-looking period should be used to project payments.

## **Projected Payments Arising from Reverse Transactions**

6.37 Under the recording approach for reverse transactions-the collateralized loan approach-a security provider records a loan liability, when cash funds are involved. In the debt-service payment schedule, the security provider records the full amount of the loan to be paid at maturity under principal. If the reverse transaction has an "open" maturity,<sup>20</sup> the loan should be recorded as on-demand, under the immediate time category in the presentation of the debt-service payment schedule, unless there is clear evidence to suggest otherwise.

## **Projected Payments on Financial Leases**

6.38 Projected payments on financial leases must be divided into interest and principal payments. The amount of interest payments can be calculated using the implicit rate of interest on the loan, with all other payments recorded as principal payments. Conceptually, at inception, the implicit rate of interest on the loan is that which equates the market value of the good provided at the time of lease initiation-the value of the loan-with the discounted

<sup>&</sup>lt;sup>19</sup> The debtor might have an option to call (buy back) external debt early, which would also result in a drain on liquidity. But unlike the put option for the creditor, this drain is unlikely to be exercised except at a convenient time for the debtor. Consequently, in assessing vulnerability, information on external debt containing put options is more significant.

<sup>&</sup>lt;sup>20</sup> "Open" maturity is where both parties agree daily to renew or terminate the agreement. Such an arrangement avoids settlement costs if both parties wish to renew the reverse transaction on a continuing basis.

value of future payments in rentals over the life of the lease, including any residual value of the good to be returned (or purchased) at the maturity of the lease.

# 7. FURTHER PRESENTATION TABLES OF EXTERNAL DEBT

# A. Introduction

7.1 This chapter introduces presentation tables that facilitate a more detailed examination of the potential liquidity and solvency risks to the economy that might arise from the acquisition of external liabilities. These tables provide information that supplements that included in the gross external debt position presented earlier in the *Guide*. More specifically, this chapter provides presentation tables on:

- External debt by short-term remaining maturity (Table 7.1);
- Debt-service payment schedule (Tables 7.2-7.5);
- Foreign and domestic currency external debt (Tables 7.6-7.9);
- Interest rates and external debt (Tables 7.10 and 7.11);
- External debt by creditor sector (Table 7.12 and 7.13);
- Net external debt position (Table 7.14);
- Reconciliation of external debt positions and flows (Table 7.15);
- Traded debt instruments (Tables 7.16 and 7.17); and
- Cross-border trade-related credit (Table 7.18).

7.2 For any individual economy, the relevance of any table in this chapter will depend upon the circumstances facing it, and so the *Guide* does not provide a list of priorities for compiling the tables ahead. Indeed, the tables are provided as flexible frameworks to be used by countries in the long-term development of their external debt statistics. Nevertheless, experience suggests that data on debt-maturity profiles and currency breakdowns are essential to a comprehensive analysis of external vulnerability for any economy. For the IMF's data dissemination standards, the tables for the debt-service payment schedule–Table 7.2 and 7.5 (Special Data Dissemination Standard, SDDS) and Table 7.3 (General Data Dissemination System, GDDS)–are relevant, as is, the table on foreign currency and domestic currency debt, Table 7.6 (SDDS).<sup>1</sup>

7.3 Because the concepts for its measurement remain consistent throughout the *Guide*, the gross external debt position for each institutional sector and for the total economy should be the same regardless of the presentation table employed, provided that the same approach to valuing debt securities is adopted throughout. In addition, because the concepts remain

<sup>&</sup>lt;sup>1</sup> Box 4.1 in Chapter 4 provides the precise requirements for the external debt category of the IMF's data dissemination standards.

consistent, if necessary, compilers can combine different characteristics of external debt in presentations other than those set out below. In disseminating data, compilers are encouraged to provide methodological notes (metadata) explaining the concepts and methods used in compiling the data.

7.4 Throughout this chapter, except where stated otherwise, the first level of disaggregation by row is by debtor sector, followed (where relevant) by maturity on an original maturity basis. In the tables, the institutional sector presentation is provided, but the presentations can also be provided on a public sector basis, as set out in Chapter 5. Because of the particular importance of both measures, the debt-service payment schedule is presented on both institutional (Table 7.2 and 7.5) and a public sector basis (Table 7.3 and Table 7.4).

# B. External Debt by Short-Term Remaining Maturity

7.5 Gross external debt position data by short-term remaining maturity for the total economy is presented in memorandum Table 4.3 (see Chapter 4). In addition, Table 7.1 is provided for presenting gross external debt position data by short-term remaining maturity further disaggregated by institutional sector. Information on the total short-term debt of the total economy, both on an original and remaining maturity basis, as well as by sector, is of analytical interest (see Box 7.1). For compiling the data for this table, direct investment: intercompany lending should be attributed to long-term maturity, unless detailed information is available to provide data on a short-term remaining maturity basis.

7.6 Compiling such information helps in the assessment of liquidity risk by indicating that part of the gross external debt position that is expected to fall due in the coming year. Also, by separately indicating short-term debt on an original maturity basis from debt on a long-term basis falling due in the coming year, the presentation provides additional information content, such as the extent to which high short-term remaining maturity data is due (or not) to significant debt payments expected on long-term debt (original maturity basis).

7.7 Total value of arrears (if applicable) and debt securities by sector are separately identified in memorandum items to Table 7.1. *Arrears* are recorded in the original instrument until the liability is extinguished, and are presented in nominal value in the memorandum items.<sup>2</sup> This *Guide* recommends that both nominal and market values be provided for debt securities (see paragraphs 2.33). For this purpose, in memorandum items to Table 7.1, debt securities are valued either at market value if they are presented at nominal value in the table, or at nominal value if they are presented at market value in the table.

<sup>&</sup>lt;sup>2</sup> Therefore, if applicable, any debt instruments listed under short-term debt on an original maturity basis and long-term obligations due for payment within one year or less in Table 7.1 may include arrears.

Table 7.1. Gross External Debt Position: Short-Term Remaining MaturityBy Sector	
	End Period
General Government	
Short-term debt on an original maturity basis	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term debt obligations due for payment within one year or less	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Central Bank	
Short-term debt on an original maturity basis	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities $2/3/$	
Long-term debt obligations due for navment within one year or less	
Currency and denosits 1/	
Debt securities	
Loope	
Trade credit and advances	
Other debt liabilities 2/	
Denocit taking Compositions, except the Control Bank	
Short term debt on an enjoined meturity basis	
Short-term debt on an original maturity basis	
Debt compution	
Leene	
Loans Trade and it and a duamage	
Other delta liebilities 2 ( 2 (	
Other debt habilities 2/3/	
Long-term debt obligations due for payment within one year or less	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Other Sectors	
Short-term debt on an original maturity basis	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term debt obligations due for payment within one year or less	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	

Other financial corporations	End Perio
Other financial corporations	
Dobt securities	
Loans	
Trade credit and advances	
Other debt liabilities $2/3/$	
Long-term debt obligations due for navment within one year or less	
Currency and denosits 1/	
Debt securities	
Leang	
Loans Trade gradit and advances	
Other debt liebilities 2 /	
Norfinancial compartations	
Short tarm dakt on an ariginal maturity basis	
Short-term debt on an original maturity basis	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term debt obligations due for payment within one year or less	
Currency and deposits 1/	
Debt securities	
Loans	_
Trade credit and advances	
Other debt liabilities 2/	
Households and nonprofit institutions serving households (NPISHs)	
Short-term debt on an original maturity basis	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/ 3/	
Long-term debt obligations due for payment within one year or less	
Currency and deposits 1/	
Debt securities	
Loans	
Trade credit and advances	
Other debt liabilities 2/	
Direct Investment: Intercompany Lending 4/	
Short-term on an original maturity basis	
Debt liabilities of direct investment enterprises to direct investors	
Debt liabilities of direct investors to direct investment enterprises	
Debt liabilities between fellow enterprises	
Long-term debt obligations due for payment within one year or less	
Debt liabilities of direct investment enterprises to direct investors	
Debt liabilities of direct investors to direct investment enterprises	
Debt liabilities between fellow enterprises	
	-
otal Short-Term External Debt (remaining maturity basis)	
Aemorandum Items	
Arrears: By Sector 3/	
General government	
Central bank	
Den exit taking comparations, succent the control bank	
Deposit-taking corporations, except the central bank	
Other sectors	
Direct investment: Intercompany lending	
Debt securities by Sector: Short-term on a remaining maturity basis 5/	
General government	
Central bank	
Denosit taking corporations, except the central bank	
Other except the central bank	
Other sectors	
Reserve related liabilities	-
/ It is recommended that all currency and deposits be included in the short-term categ	ory unless
letailed information is available to make the short-term/long-term attribution.	
/ Other debt liabilities comprise insurance, pension, and standardized guarantees sche	mes, and oth
ccounts payable-other in the IIP statement.	
Arrears are recorded in the original debt instrument rather than in other dobt liability	ties short tor
/ If data an interconnection dies an a short term remetide an estimate it.	ale
7 In data on intercompany lending on a short-term remaining maturity basis are available to be available to	ле. 
/ Debt securities valued at market value if they are presented at nominal value in the ta	able, or at
	amaradum
iominal value if they are presented at market value in the table. Debt securities in the m	lemoradum

7.8 Reserve related liabilities (on a remaining maturity basis) are also separately identified in the memorandum items to Table 7.1. This information is of analytical interest to assess reserve assets data (see paragraph 3.46).

7.9 The concept of short-term remaining maturity can also be applied to other tables in this chapter, such as those relating to foreign-currency external debt.

# C. Debt-Service Payment Schedule

7.10 Like the short-term remaining maturity presentation table, as mentioned in the previous chapter, a debt-service payment schedule supports the assessment of liquidity risk.

7.11 Table 7.2 gives a presentation of a debt-service payment schedule. The data to be presented in this table are projected future payments of interest and principal on gross external debt outstanding on the reference date.<sup>3</sup> The data should not cover projected future payments on external debt not yet outstanding. Direct investment: intercompany lending is separately identified, although it is recognized that sometimes the payments schedule on debt liabilities between related enterprises might not always be known with precision.

<sup>&</sup>lt;sup>3</sup> Debt-service payments can also be projected on the basis not only of outstanding debt on the reference date but additionally on debt not yet, but expected to be, outstanding-for example, loans that have been agreed but not disbursed and short-term debt that might be assumed to be renewed. This *Guide* does not provide guidance for projecting payments on expected disbursements because its focus is on outstanding, and not projected, debt.

#### Further Presentation Tables of External Debt

Table 7.2. Debt-Service Payment Schedule By Sector								
		·	For C	utstanding Exte	ernal Debt as at	End-Period		•
			One year or les	5		More than one	year to two years	More than two
			(months)			(ma	onths)	years
	immediate 1/	More than 0 to	More than 3 to 6	More than 6 to	More than 9 to	More than 12 to	More than 18 to	
		3		9	12	18	24	
General Government								
Special drawing rights (SDRs), Allocation								
Principal								
Interest								
Currency and deposits								
Principal								
Interest								
Debt securities								
Principal								
Interest								
Loans								
Principal								
Interest								
Trade credit and advances								
Principal								
Interest								
Other debt liabilities 2/3/								
Principal								
Interest								
Central Bank								
Special drawing rights (SDRs), Allocation								
Principal								
Interest								
Currency and deposits								
Principal								
Interest								
Debt securities								
Principal								
Interest								
Loans								
Principal								
Interest								
Trade credit and advances								
Principal								
Interest								
Other debt liabilities 2/3/								
Principal								
Interest								
Deposit-Taking Corporations, except the Central Bank								
Currency and deposits								
Principal								
Interest								
Debt securities								
Principal								
interest								
Drincipal								
r i nicipal								
Trade credit and advances								
Principal								
Interest								
Other debt liabilities 2/3/								
Princinal								
Interest								
Other Sectors								
Currency and deposits								
Principal								
Interest								
Debt securities								
Principal								
Interest								
Loans								
Principal								
Interest								
Trade credit and advances								
Principal								
Interest								
Other debt liabilities 2/3/								
Principal								1
Interest								

#### External Debt Statistics: Guide for Compilers and Users

Table 7.2. Debt-Service Payment Schedule By Sector (Continued)								
			For O	utstanding Exte	ernal Debt as at	End-Period	·	
		(	One year or les	s		More than one y	/ear to two years	More than two
			(months)			(mo	nths)	years
	immediate 1/	More than 0 to 3	More than 3 to 6	More than 6 to 9	More than 9 to 12	More than 12 to	More than 18 to 24	
Other financial corporations					**	10	2.	
Currency and deposits								
Principal								
Interest								
Debt securities								
Principal								
Interest								
Loans								
Principal								
Trade credit and advances								
Principal								
Interest								
Other debt liabilities 2/3/								
Principal								
Interest								
Nonfinancial corporations								
Currency and deposits								
Principal								
Interest								
Debt securities								
Principal								
Interest								
Loans								
Principal								
Interest								
Trade credit and advances								
Principal								
Other debt liabilities 2/2/								
Principal								
Interest								
Households and nonprofit institutions serving households (NPISHs)								
Currency and deposits								
Principal								
Interest								
Debt securities								
Principal								
Interest								
Loans								
Principal								
Interest								
Trade credit and advances								
Principal								
Interest								
Other debt liabilities 2/ 3/								
Principal								
Interest								
Direct investment: Intercompany lending								
Principal								
Interest								
Debt liabilities of direct investors to direct investment enterprises								
Principal								1
Interest								1
Debt liabilities between fellow enterprises								
Principal								
Interest								
Gross External Debt Payments								
Principal								
Interest								l
Memorandum Items								
Securities with Embedded Options 4/								
Bringing								
Interest								
Control Bonk								
Principal								
Interest								
Deposit-taking Corporations, except the Central Bank								
Principal								
Interest								1
Other Sectors								1
Principal								
Interest								
1/ Immediately available on demand and/or immediately due (including arrears a	and interest on	arrears).						
2/ Other debt liabilities comprise insurance, pension, and standardized guarantee	s schemes, and	l other accounts	payable-other	in the IIP state	ment.			
3/ Arrears are recorded in the original debt instrument rather than in other debt li	abilities, short	term.						
4/ Include only those securities that contain an embedded option with a date on w	hich or after w	hich the debt c	an be sold back	to the debtor.				

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#### Box 7.1. High-Frequency Debt-Monitoring Systems

To enable authorities to monitor developments in short-term capital flows as a source of external vulnerability, a number of countries, with the help of IMF staff, have developed monitoring systems that generate timely high-frequency data on the liabilities of domestic banks to foreign banks. This box briefly sets out the rationale for such systems, their coverage, the institutional considerations, and the use of these data.

#### **Rationale and Design Objective**

High-frequency debt-monitoring systems are intended to monitor developments in short-term financial flows, which are a major source of external vulnerability and an important factor in crisis prevention and/or resolution. Such systems are designed to obtain high-quality data within very short time intervals (typically, a day).

#### Coverage

Given these objectives, high-frequency debt-monitoring systems are typically limited to cover consolidated interbank transactions of domestic banks, including their offshore branches and subsidiaries, vis-à-vis foreign banks. The core set of instruments that are typically covered include short-term interbank credits, trade credit lines, payments falling due on medium- and long-term loans, and receipts and payments related to financial derivatives. Reporting institutions usually provide data on amounts due and paid in the reporting period, new lines extended, interest spreads over LIBOR, and maturities. As regards country classification, individual banks are attributed to the country in which their headquarters is located.

#### **Institutional Considerations**

Monitoring systems have been tailored to the specific circumstances of individual countries. However, there are certain minimum requirements-in general, a capacity to collect, process, and communicate highquality data with short lags. Key factors in the success of such systems include close coordination between the authorities and banks, which may be facilitated by preexisting reporting requirements, and the proportion of external financial flows being channeled through the domestic banking system (and, if relevant, other reporting institutions). Although a capacity must be developed to respond promptly to questions, and to identify and approach banks about emerging problems, the authorities need to be sensitive to concerns that private sector participants might misinterpret requests for information.

#### Use and Interpretation of Data

The information provided permits the tracking of rollover rates, changes in exposure and the terms of external obligations, which help to assess changes in international capital market conditions and creditors' assessments of the borrowing country. (It may also reveal differing assessments of different institutions within the country.) Interpretation of the data involves considerable judgment, requiring analysis of supply-and demand-side factors in order to shed more light on the agents' motivations behind the monitored transactions and thus the soundness of a country's external position. Supply-side considerations include factors such as shifts in creditor bank strategies, banking sector or country risk, and institutional/regulatory changes in the source country. Demand for interbank lines may be affected, for example, by fluctuations of imports or an increase/decrease in the reliance on local financing sources, such as foreign currency time deposits.

7.12 In the table, the columns are time periods of one year and less, over one year to two years, and over two years. The time frame in the table could be extended. Annual payment data for each year from two years up to five years ahead would help to identify potential significant payment amounts well in advance. Some countries provide annual data for each year out to 10 or 15 years.

7.13 Subperiods are presented within the time periods of one year or less, and over one year to two years: in the one year or less period, quarterly subperiods are presented together with an "immediate" category (see below); in the over one year to two years time period, semiannual (semester) subperiods are presented. The column "more than 0 to 3" months covers payments of up to three months (excluding those payments falling under "immediate"); the column "more than 3 to 6" months covers payments due in more than three months up to six months; the column "more than 6 to 9" months covers payments due in more than nine months; the column "more than 9 to 12" months covers payments due in more than 12 to 18" months covers payments due in more than 12 months up to 18 months; the column "more than 18 to 24" months covers payments due in more than 18 months up to 24 months.

7.14 The time period of one year or less includes a subperiod of "immediate" that covers all debt that is payable on demand-for example, certain types of bank deposits, as well as debt that is past due (arrears, including interest on arrears). Debt that is technically due immediately is different in nature from debt due in one year or less because the actual timing of payment on debt due immediately is uncertain. Without an "immediate" time period specified, there is a possibility that an analytically misleading impression could be given by the data for short-term debt-some of this debt might not be repaid for some time.

7.15 For public debt managers, the monitoring of the debt-service payment schedule for public and publicly guaranteed debt is essential for debt management strategy and to ensure that payments are made on a timely basis. Table 7.3 provides a debt-service payment schedule that presents debt-service payments on a public sector basis but is otherwise identical to Table 7.2. Table 7.4 presents a debt service payment schedule on a public sector basis with no instrument breakdown. Subperiods are presented within time periods of one year or less, over one year to two years and over two years (each year from over two years up to five years ahead, and for two five-year groups, and data for over 15 years). The time frame of Table 7.4 can also be applied to the other tables that present a debt-service payment schedule (Tables 7.2 and 7.3).

Table 7.5. Dept-Service Payment Schedule: Public and Publicly-G	y-Guaranteed Debt and Private Sector Debt Not Publiciy Guaranteed							
	For Outstanding External Debt as at End-Period							
		One year or less More than one year to two years						More than
			(months)			(n	nonths)	two years
	immediate	More than 0	More than 3	More than 6	More than 9	More than	More than 18 to	
Public and Publicly-Guaranteed External Debt	1/	10 3	100	10 9	1012	12 10 18	24	
Special drawing rights (SDRs), Allocation								
Principal								
Interest								
Currency and deposits								
Principal								
Interest								
Debt securities								
Principal								
Interest								
Loans								
Principal								
Interest								
Trade credit and advances								
Principal								
Other debt lightlities 2/3/	1	-						
Principal								
Interpet								
Direct investment: Intercompany lending	1	1						
Debt liabilities of direct investment enterprises to direct investors								
Principal								
Interest								
Debt liabilities of direct investors to direct investment enterprises								
Principal								
Interest								
Debt liabilities between fellow enterprises								
Principal								
Interest								
Private Sector External Debt Not Publicly Guaranteed								
Currency and deposits								
Principal								
Interest								
Debt securities								
Principal								
Interest								
Dringing								
Interact								
Trade credit and advances								
Principal								
Interest								
Other debt liabilities 2/3/								
Principal								
Interest								
Direct investment: Intercompany lending								
Debt liabilities of direct investment enterprises to direct investors								
Principal		-	-					
Interest			-					
Debt habilities of direct investors to direct investment enterprises								
Principal		-						
Interest Debt liabilities between fellow enterprises								
Debt nabinities between renow enterprises								
Interest	1	-						
Gross External Debt Payments								
Principal								
Interest		-						
Memorandum Items								
Securities with Embedded Options 4/				1				
Public and Publicly-Guaranteed External Debt								
Principal								
Interest	1							
Private Sector External Debt Not Publicly Guaranteed								
Principal								
Interest								
1/ Immediately available on demand and/or immediately due (includi	ng arrears and	interest on a	rrears).					
2/ Other debt liabilities comprise insurance, pension, and standardized	d guarantees s	chemes, and o	ther accounts	payable-other	in the IIP stat	ement.		
3/ Arrears are recorded in the original debt instrument rather than in o	ther debt liabi	lities, short te	erm.					
A / In all of a surface the second state the second state and surface and surface and share a state	a data an codel	ale and a fit and a late	المراجع والمراجع والمراجع					

#### Further Presentation Tables of External Debt

7.16 The SDR debt payment schedule in these tables is presented as follows: interest should include interest payments on SDR allocations. The SDR allocation reported for the most recent period in the gross external debt position data should be included as principal in the "more than two years" column in Tables 7.2 and 7.3, and in the "more than 15" years column in Table 7.4. For the purpose of these tables, interest payments are not shown in the "more than two years" column in Tables 7.2 and 7.3, and in the "more than 15" years column in Tables 7.2 and 7.3, and in the "more than 15" years column in Tables 7.2 and 7.3, and in the "more than 15" years column in Tables 7.4.

7.17 When securities contain an embedded option with a date on which or after which the debt can be put (sold) back to the debtor by the creditor, as explained in the previous chapter,

the preference of the *Guide* is that projected payments in Tables 7.2-7.4 be estimated without reference to these embedded put options, but that memorandum items on projected payments be provided assuming early repayment at the option date.

7.18 If national practice is to estimate projected payments on bonds with embedded put options only until the option date, additional memorandum information could be provided on the projected payments on the bond up until the original maturity date.

7.19 Other embedded options might not include a set date, but their exercise may be dependent on certain conditions occurring, such as a credit rating downgrade, or in the instance of a convertible bond, the price of equity reaching a certain level. While no memorandum item is provided for these instruments, where significant, additional data could be compiled on the value and type of this external debt. In particular, and if significant, credit-linked note instruments should be separately identified in a memorandum item. In some economies, there may be interest in historical debt-service data-that is, past payments of principal and interest on long-term borrowings including prepayments of debt.

Table 7.4. Debt-Service Payment Schedule: P	ublic and Pul	blicly-Gu	iarantee	ed Debt									
For Outstanding Public and Publicy Guaranteed External Debt as at End-Period													
		One ye	ear or les	<b>SS</b>		More than one y	ear to two years		N	Aore tha	n two yea	rs	
	(months)			(months)			(years)						
	immediate1/	More	More	More	More	More than 12 to	More than 18	3	4	5	More	More	More
		than 0	than 3	than 6	than 9	18	to24				than 5	than 10	than 15
		to 3	to 6	to 9	to 12						to 10	to 15	1
Public Sector External Debt													
Principal													
Interest													
Publicly-Guaranteed Private Sector External													
Principal													
Interest													
Total													
Principal													
Interest													
1 / Immodiately available on domand and (or imm	odiatoly duo (	includin	a arroare	and inte	proct on a	rroarc)							

7.20 To address the analytical need for detailed data on external debt payments coming due in the next 12 months, Table 7.5 presents the principal and interest payments due in one year or less on the outstanding external debt, broken down by institutional sector. This table is a simplified version of, but not a substitute for, the debt service payment schedule presented in Table 7.2.

in One Year or LessBy Sector	-
	For Outstanding External Debt as at End-Period
General Government	
Principal	
Interest	
Central Bank	
Principal	
Interest	
Deposit-Taking Corporations, except the Central Bank	
Principal	
Interest	
Other Sectors	
Principal	
Interest	
Direct investment-Intercompany lending	
Principal	
Interest	
Total	
Principal	
Interest	

Table 7.5. Gross External Debt Position: Principal and Interest Payments Due in One Year or Less--By Sector

#### D. Foreign Currency and Domestic Currency External Debt

7.21 Experience suggests that information on the currency composition of the gross external debt position is necessary for monitoring an economy's potential vulnerability to solvency and liquidity risk. For instance, a depreciation of the exchange rate can increase the burden of foreign currency debt liabilities in domestic currency terms for the resident debtor (although there may be beneficial effects such as an improvement in the competitiveness of an economy's exports of goods and services), while payments on foreign currency debt can cause downward pressure on the domestic exchange rate and/or outflows of foreign currency from the economy. Some of the impact can be offset through the use of financial derivatives, and natural hedges such as foreign currency assets and income, but, unlike the domestic currency, the domestic monetary authority cannot create additional foreign currency.

7.22 Four tables are provided to help users understand the risks to the economy of foreign currency external debt. Table 7.6 is a simple foreign currency/ domestic currency split of the gross external debt position; Table 7.7 is similar to Table 7.6 but provides detailed breakdown by institutional sector, maturity, and type of debt instrument; Table 7.8 provides more information on the foreign currency external debt position; and Table 7.9 provides information on foreign currency payments.

#### Domestic Currency/Foreign Currency Split of the Gross External Debt Position

7.23 Table 7.6 provides information on the foreign currency and domestic currency split by currency of denomination of the gross external debt position for the total economy.<sup>4</sup> The definition of foreign currency debt in this table includes both foreign currency<sup>5</sup> and foreigncurrency-linked debt (see paragraph 6.13). Foreign-currency-linked debt is included with foreign currency debt because a depreciation of the exchange rate can increase the burden of foreign-currency-linked debt liabilities in domestic currency terms for the resident debtor. In recognition that for some sectors, such as nonfinancial corporations and households, there may be difficulties in obtaining comprehensive data on the domestic currency/foreign currency split, the table includes an "unallocated" category.

Table 7.6. Gross External Debt Position: Foreign Currency and Domestic

Currency Denominated Debt	arrency and Domestic
	End Period
Foreign currency 1/	
Short-term	
Long-term	
Domestic currency	
Short-term	
Long-term	
Unallocated	
Gross External Debt	
Memorandum Items	
	End Period
Debt securities (at nominal value)	
Foreign currency 1/	
Short-term	
Long-term	
Domestic currency	
Short-term	
Long-term	
Unallocated	
Debt securities (at market value)	
Foreign currency 1/	
Short-term	
Long-term	
Domestic currency	
Short-term	
Long-term	
Unallocated	
1/Includes foreign-currency-linked debt	

<sup>&</sup>lt;sup>4</sup> The currency of settlement may be different from the currency of denomination (see paragraph 6.13), and if significant, attribution of external debt by currency of settlement can be presented as a separate subcategory.

<sup>&</sup>lt;sup>5</sup> Including external debt payable in a foreign currency but with the amounts to be paid linked to a domestic currency.

7.24 A special case arises where an economy uses as its legal tender a currency issued by a monetary authority of another economy-such as U.S. dollars-or of a common currency area to which the economy does not belong. While this currency is to be classified as a foreign currency, it has some of the attributes of a domestic currency because domestic transactions are settled in this currency. With this in mind, information could be separately provided on external debt payable in and/or linked to a foreign currency used as legal tender in the domestic economy, and other foreign currency external debt.

7.25 Debt securities by foreign and domestic currency, and by maturity, presented in nominal and market value, are separately identified in memorandum item to Table 7.6. This table is based on the original maturity concept, data could also be compiled on a remaining-maturity basis. If significant, the foreign currency debt could be disaggregated into external debt that is payable in foreign currency and external debt that is payable in domestic currency but with the amounts to be paid linked to a foreign currency (foreign-currency-linked debt). Further disaggregation of the table into institutional sectors and instruments is provided in Table 7.7.<sup>6</sup>

<sup>&</sup>lt;sup>6</sup> This table is similar to *BPM6* supplementary Table A9-III-2a. on currency composition by sector and instrument of debt liabilities to nonresidents.

Sector				
	Foreign	Domestic	Unallocated	Total
	currency	currency	Unanocateu	Total
General Government				
Short-term				
Currency and deposits 1/				
Debt securities				
Loans				
Trade credit and advances				
Other debt liabilities 2/ 3/				
Long-term				
Special drawing rights (SDRs)				
Currency and deposits 1/				
Debt securities				
Loans				
Trade credit and advances				
Other debt liabilities 2/				
Central Bank				
Short-term				
Currency and deposits 1/				
Debt securities				
Loans				
Trade credit and advances				
Other debt liabilities 2/ 3/				
Long-term				
Special drawing rights (SDRs)				
Currency and deposits 1/				
Debt securities				
Loans				
Trade credit and advances				
Other debt liabilities 2/				
Denosit-Taking Corporations, except the Central Bank				
Short-term				
Currency and denosits 1/				
Debt securities				
Loans				
Trade credit and advances				
Other debt liabilities 2/3/				
Long-term				
Currency and denosits 1/				
Debt securities				
Loans				
Trade credit and advances				
Other debt liabilities 2/				
Other Sectors				
Chort torm				
Short-term				
Debt securities				
Leans				
Lodiis Trade and it and advances				
Other debt lightliting 2/2/				
Long torm				
Long-term				
Currency and deposits 1/				
Debt securities				
Loans				
Trade credit and advances				
Other debt liabilities 2/				
Short town				
Snort-term				
Dept habilities of direct investment enterprises to direct investors				
Debt liabilities of direct investors to direct investment enterprises				
Debt liabilities between fellow enterprises				
Long-term				
Debt liabilities of direct investment enterprises to direct investors				
Debt liabilities of direct investors to direct investment enterprises				
Debt liabilities between fellow enterprises	1			
Gross External Debt				
1/ It is recommended that all currency and deposits be included in the	short-term ca	tegory unles:	s detailed inforn	nation is
available to make the short-term /long-term attribution.		5 5		
2/ Other debt liabilities comprise insurance pension and standardized	guarantees s	chemes and	other accounts a	navable-
other in the IIP statement	- But milles 3	enemies, anu	saler accounts j	payable
outer in the lif Statement.				

Table 7.7. Gross External Debt Position: Foreign Currency and Domestic Currency Denominated Debt by Sector

100

3/ Arrears are recorded in the original debt instrument rather than in other debt liabilities, short term.

#### **Gross Foreign Currency External Debt**

7.26 For those economies with significant gross foreign currency external debt, Table 7.8 presents more detailed information on the position. This table provides an attribution of foreign currency (including foreign-currency-linked external debt) by major foreign currency-U.S. dollars, euros, and Japanese yen. Further individual currencies could be added. Dissemination of this detailed information is encouraged because it provides further information on the exposure to exchange rate movements to that set out in Tables 7.6-7.7.

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Table 7.8. Gross External Foreign Currency and Foreign-Currency-Linked Debt Position						
	Total	US dollar	End-Period	Von	Other	
General Government	Total	0.5. uonar	EulU	Ten	otilei	
Short-term 1/						
Long-term						
Short-term 1/						
Long-term						
Deposit-Taking Corporations, except the Central Bank						
Short-term 1/						
Long-term						
Other Sectors						
Long-term						
Other financial corporations						
Short-term 1/						
Long-term						
Nonfinancial corporations						
Long-term						
Households and nonprofit institutions serving households						
Short-term 1/						
Long-term						
Direct investment: Intercompany lending						
Debt liabilities of direct investment enterprises to direct investors		-				
Debt liabilities between fellow enterprises						
Gross External Foreign Currency and Foreign-Currency-Linked Debt						
Position						
Memorandum Items						
Financial Derivatives: Notional Value of Foreign Currency and						
Foreign-Currency-Linked Contracts with Nonresidents 2/						
To Receive Foreign Currency						
General Government						
Ontions						
Central Bank						
Forwards						
Options						
Deposit-Taking Corporations, except the Central Bank						
Ontions						
Other sectors						
Forwards						
Options						
Other financial corporations						
Ontions						
Nonfinancial corporations						
Forwards						
Options						
Households and nonprofit institutions serving households NPISHs)						
Forwards						
To Pay Foreign Currency						
General Government						
Forwards						
Options Control Dark						
Forwards						
Ontions					-	
Deposit-taking Corporations, except the Central Bank						
Forwards						
Options						
Uther sectors Forwards						
Ontions		1				
Other financial corporations						
Forwards						
Options						
Nonfinancial corporations						
rorwards Ontions						
Households and nonprofit institutions corving households						
Forwards					+	
Options						
1/ It is recommended that all currency and deposits be included in the	short-term	category un	less detaile	d informat	ion is	
available to make the short-term/long-term attribution.						
2 / Evolution financial derivatives that are included in reserve assets dat	at that is fi	nancial dori	vatives that	northin to	tho	

2/ Excludes financial derivatives that are included in reserve assets data; that is, financial derivatives that pertain to the management of reserve assets, are integral to the valuation of such assets, are settled in foreign currency, and are under the effective control of the monetary authority.

7.27 Table 7.8 could be extended to also include foreign currency and foreign-currencylinked debt owed by each resident sector to each other resident institutional sector. While such debt is beyond the definition of external debt, it can result in cross-institutional sector transfers of income when there are movements in the domestic exchange rate vis-à-vis foreign currencies, thus affecting economic activity and financial stability. However, if such data are added to the data on nonresident claims, it should be remembered that if, for example, a resident bank funds a foreign currency loan to a resident corporation by borrowing from a nonresident, the foreign currency liabilities would appear in both the resident/resident and resident/ nonresident data.

7.28 In the special case where an economy uses as its legal tender a foreign currency, borrowing in this currency from nonresidents could be separately identified in the table.

7.29 A memorandum item is provided in Table 7.8 for the notional value-the amount underlying a financial derivatives contract that is necessary for calculating payments or receipts on the contract-of foreign currency and foreign-currency-linked financial derivatives contracts with nonresidents both to receive and pay foreign currency, and by type of currency.<sup>7</sup> A financial derivatives contract to purchase foreign currency with domestic currency is classified as a financial derivative to receive foreign currency. If instead the contract is to purchase domestic currency with foreign currency at a future date, this is a financial derivative to pay foreign currency. Similarly, an option to buy foreign currency (sell domestic currency) is classified as a financial derivative to receive foreign currency, and vice versa. Determining the currency of denomination is not always clear in financial derivative contracts to purchase or sell foreign currency using domestic currency. The decisive factor in determining whether the financial derivative is to be classified as receiving or paying foreign currency is the exposure to currency movements, so if payment of a financial derivatives contract is linked to a foreign currency even though payment is required in domestic currency, the financial derivative is to be classified as a contract to pay foreign currency, and vice versa.

7.30 Through the use of financial derivatives, the economy could become more, or less, exposed to exchange rate risk than is evidenced in the gross foreign currency external debt data; in this context, the notional value data-by providing a broad indication of the potential transfer of price risk underlying the financial derivatives contract-are analytically useful.

7.31 The notional amount is comparable with the values for debt instruments; for instance, if a foreign currency debt instrument is issued and the proceeds sold for domestic currency with an agreement to repurchase the foreign currency with domestic currency at a future date-known as a currency or forex swap-the notional amount of the financial derivative is equal to the amount swapped. Therefore, these amounts provide an indication of the scale of activity by institutional sectors in foreign currency financial derivatives; the extent to which institutional sectors might be covering the foreign currency risk of their borrowing; and/or the extent to which institutional sectors may be exposed to foreign currency risk through

<sup>&</sup>lt;sup>7</sup> For those economies that use a foreign currency-such as the U.S. dollar-as legal tender, information on the notional value of foreign currency derivatives to receive and pay this foreign currency-such as U.S. dollars-could be presented.

financial derivatives contracts. Table 7.8 distinguishes between forwards and options and so can be used to indicate their relative shares of total foreign currency financial derivatives.

7.32 A breakdown of positions by institutional sector into forwards (including swaps) and options is provided because of their different characteristics. Notably, forwards are likely to involve the delivery or receipt of the notional amount of foreign currency underlying the contract, whereas the settlement of an option is likely to involve only a net settlement of the market value.<sup>8</sup>

7.33 If a single financial derivatives contract both pays and receives foreign currency, the notional amount should be included under both pay and receive foreign currency. Not only does this ensure completeness of reporting, it also allows for the possibility of attributing financial derivatives contracts by type of currency. If a financial derivatives contract requires the payment or receipt of foreign currency in return for something other than a currency (for example, a commodity), the notional amount should be included under either the receipt or payment of the foreign currency, as appropriate. If these contracts are significant, they could be separately identified.

# Projected Payments in Foreign Currencies Vis-à-Vis Nonresidents

7.34 Table 7.9 sets out a foreign currency payment schedule, and a memorandum item of selected foreign currency and foreign-currency-linked external asset positions. It provides an idea of the future potential drains of foreign currency resources from the economy to nonresidents, along with the external foreign currency assets that may be available to meet such drains in the short-term. While there is always difficulty in ascertaining the extent to which it might be possible to use assets to meet outstanding debt obligations as they come due, the memorandum item provides a broad approximation of the concept of foreign currency liquidity by listing selected asset types that would most likely be available in the short term. Only obligations to and claims on nonresidents are to be included in this table.

<sup>&</sup>lt;sup>8</sup> According to data published semiannually by the Bank for International Settlements (BIS), market values of foreign currency options are typically around 2-4 percent of the notional amount.

	For External Debt and Derivatives Contracts Outstanding as at End-Period								
	One year or less				More than one year to two years More				
	(months)			(months)		two years			
	immediate2/	More than 0 to	More than 3 to	More than 6 to	More than 9 to	More than 12 to	More than 18 to		
Deposit-Taking Corporations, except the Central Bank		3	0	y	12	10	24		
Foreign currency external debt payments									
Requirements under forward financial derivatives contracts									
To deliver foreign currency									
To receive foreign currency									
Other financial corporations									
Foreign currency external debt payments									
Requirements under forward financial derivatives contracts									
To deliver foreign currency									
To receive foreign currency									
Nonfinancial corporations									
Foreign currency external debt payments									
Requirements under forward financial derivatives contracts									
To deliver foreign currency									
To receive foreign currency									
Memorandum item									
Selected Foreign Currency and Foreign-Currency-Linked External Asset Positions									
Deposit-taking Corporations, except the Central Bank									
Short-term									
Currency and deposits									
Debt securities									
Loans									
Trade credit and advances									
Other debt assets 3/									
Long-term									
Equities									
Debt securities									
Other financial corporations									
Short-term									
Currency and deposits									
Debt securities									
Loans									
Trade credit and advances									
Other debt assets 3/									
Long-term									
Equities									
Debt securities									
Nonfinancial corporations									
Short-term									
Currency and deposits									
Debt securities									
Loans									
Trade credit and advances									
Other debt assets 3/									
Long-term									
Equities									
Debt securities									
1 / Derum onto that are gottlad in farrian summer as regardlage of t	a currency o	E donominatio		1			1		

#### **Further Presentation Tables of External Debt**

7.35 The deposit-taking corporations, except the central bank, other financial corporations, and nonfinancial corporations are presented in the table, but not the central bank and general government sectors because a framework for the dissemination of similar, but not identical, data for these two sectors is provided by the Data Template on International Reserves and Foreign Currency Liquidity.<sup>9</sup> However, the table could be extended to cover these sectors.

<sup>&</sup>lt;sup>9</sup> This is a template on international reserves and foreign currency liquidity that was introduced as a prescribed component of the SDDS in March 1999 by the IMF's Executive Board. The template provides a

7.36 The rows in the table present types of foreign currency payments (and receipts); the time period columns are defined identically to those in the debt-service schedule (Table 7.2).<sup>10</sup> Because the focus is on foreign currency drains, all payments in domestic currency, even if linked to a foreign currency, are excluded. Foreign currency external debt payments are those payments that are included in the debt service payment schedule and are required in foreign currency (that is, settled in foreign currency). The requirements to deliver and receive foreign currency from nonresidents under forward contracts include only contractual agreements to deliver and receive the nominal (notional) amounts of foreign currency underlying forward contracts, such as forward foreign exchange contracts, and cross-currency swaps, on contracts current and outstanding at the reference date.

7.37 This item is not intended to include projected net settlements of financial derivatives contracts involving foreign currency, because such amounts are not required under the contract and are not known until the time of settlement.<sup>11</sup> Consequently, contracts such as options and nondeliverable forwards that require only net settlement are not covered by this table. However, such contracts contribute relatively little to the value of foreign currency delivered under financial derivatives because the settlement amounts are much smaller than the notional amount and because these types of contracts have a relatively small share of the market.

7.38 The memorandum item in Table 7.9 covers positions in (and not payments of) foreign currency and foreign-currency-linked debt instruments that represent claims on nonresidents—a subcategory of the debt assets presented in the net external debt table (see Table 7.14)—plus foreign currency and foreign-currency-linked equity securities. The instruments in the table are selected on the assumption that they represent assets that might be available to meet a sudden drain of foreign currency liquid assets. All short-term instruments (defined on an original maturity basis) are included along with those long-term instruments (original maturity basis) that are negotiable (equity and debt securities). Foreign-

considerably greater degree of transparency on international reserves and foreign currency borrowing by the authorities than hitherto. Details are provided in the *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template*, see

http://www.imf.org/external/np/sta/ir/IRProcessWeb/index.aspx). These guidelines—originally issued in 2001—were updated in 2012 to ensure consistency with the adoption of *BPM6* and to address some clarifications that were needed to reflect IMF experience with economies that report data in the Reserves Data Template.

<sup>10</sup> This table could be extended to also include foreign currency payments and receipts to each other resident institutional sector. However, as mentioned in paragraph 7.27, combining resident/nonresident and resident/resident foreign currency data could result in double counting (for example, payments on a foreign currency loan by a resident corporation that was funded by a domestic bank from abroad).

<sup>11</sup> As set out in Chapter 6, paragraph 6.27, future requirements to pay/receive foreign currency under forward derivatives contracts are to be converted into the unit of account at the market (spot) rate on the reference date; that is, consistent with the foreign-currency-conversion approach adopted throughout the *Guide*. Consequently, any gains or losses in the unit of account on these financial derivatives contracts are not reflected in this table, but would be reflected in the market value data to be reported in the financial derivatives memorandum table presented in Chapter 4 (Table 4.4) and in the net external debt position table set out later in this chapter (see Table 7.14).

currency-linked assets are included to ensure consistency with the foreign currency and foreign-currency-linked external debt position data presented in Table 7.8. Indeed, foreign currency liabilities might be hedged by foreign-currency-linked assets, and vice versa. If foreign-currency-linked assets become significant, they could be separately identified.

#### E. Interest Rates and External Debt

#### **Interest Rate Composition of External Debt**

7.39 As with the currency composition, experience suggests that information on the interest rate composition of the gross external debt position can be necessary for monitoring an economy's potential vulnerability to solvency and liquidity risk. For instance, economies with high amounts of variable-rate debt are vulnerable to a sharp increase in interest rates. Hence, Table 7.10 provides a presentation of the amounts of the gross external debt position, both in relative and absolute terms, on which interest is fixed-rate and variable-rate. Along with the value, for each cell the percentage contribution to external debt is presented. In this table, the purchase of a separate financial derivatives contract, which might alter the effective nature of the interest cash payments, does not affect the classification of the underlying instrument (see also below).<sup>12</sup>

<sup>&</sup>lt;sup>12</sup> If debt whose interest is linked to a reference index or commodity/financial instrument price and which is fixed unless the reference index or price passes a particular threshold is significant—see paragraph 6.16 for the classification of these debt instruments, additional information could be provided in notes to the tables.

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Table 7.10. Gross External Debt Position: Interest Rate Composition					
	Fixed-rate-linked		End Period Variable-rate-linked		
	Amount	Percent of total	Amount	Percent of total	Total
General Government					
Short-term 1/					
Long-term					
Central Bank					
Short-term 1/					
Long-term					
Deposit-Taking Corporations, except the Central Bank					
Short-term 1/					
Long-term					
Other Sectors					
Short-term 1/					
Long-term					
Other financial corporations					
Short-term 1/					
Long-term					
Nonfinancial corporations					
Short-term 1/					
Long-term					
Households and nonprofit institutions serving households (NPISHs)					
Short-term 1/					
Long-term					
Direct investment: Intercompany lending					
Debt liabilities of direct investment enterprises to direct investors					
Debt liabilities of direct investors to direct investment enterprises					
Debt liabilities between fellow enterprises					
Gross External Debt					
(percentage of total external debt)					
Memorandum Items (to include if significant)					
Notional Value of Financial Derivatives: Single-Currency Interest Rate-Related					
Contracts 2/					
To receive fixed-rate-linked payment					
General Government					
Central Bank					
Deposit-Taking Corporations, except the Central Bank					
Other sectors					
Other financial corporations					
Nonfinancial corporations					
Households and nonprofit institutions serving households (NPISHs)					
From direct investors, direct investment enterprises, and fellow enterprises					
To receive variable-rate-linked payment					
General Government					
Central Bank					
Deposit-Taking Corporations, except the Central Bank					
Other sectors					
Other financial corporations					
Nonfinancial corporations					
Households and nonprofit institutions serving households (NPISHs)					
From direct investors, direct investment enterprises, and fellow enterprises					
1/ It is recommended that all currency and deposits be included in the short-term	m category un	less detailed ir	formation is a	available to ma	ke the
short-term/long-term attribution.			. 1		

A memorandum item is provided on the notional (or nominal) value of single-7.40 currency financial derivatives contracts with nonresidents for instances where the amounts involved are significant. These are broken down into contracts to receive fixed-rate-related cash payments and receive variable-rate-related cash payments. For instance, if all sectors reported that their external debt was all fixed-rate-linked but they had entered into derivatives contracts with nonresidents to swap all their interest payments into variable-rate-related
payments, then the memorandum item would show that despite the apparent exposure of the economy to fixed-rate interest rates, it is actually exposed to variable rates.

7.41 In financial derivatives markets, interest rate contracts are typically referenced to a variable-rate index. To receive variable-rate-linked is to pay fixed-rate-linked, and vice versa. A financial derivative that receives variable-rate-linked is one that would have an increasing positive value, or a decreasing negative value, as the variable rate specified in the contract increases; similarly, a financial derivative that receives fixed-rate-linked has an increasing positive value, or a decreasing negative value, as the variable rate specified in the contract increases; similarly, a financial derivative that receives fixed-rate-linked has an increasing positive value, or a decreasing negative value, as the variable rate specified in the contract decreases.

## **Average Interest Rates**

7.42 There is analytical interest in average interest rates on external debt. While financial derivatives contracts might arguably render these data less relevant than otherwise, these data provide information on the borrowing costs of the economy and can be used to help estimate debt-service interest rate payments, or be used to cross-check those data. In addition, concessionality of borrowing can be imputed. Information on average interest rates on direct investment borrowing is of value because, often for tax reasons, average interest rates on this debt can vary widely. Information on average interest rates on short- and long-term original maturity instruments, by institutional sector, could additionally be provided.

7.43 In addition to weighted-average interest rates on outstanding external debt, Table 7.11 could be used to present data on the weighted-average level of interest rates agreed on new borrowing during the period.

Table 7.11. Gross External Debt Position: Average Interest Rates	
	<b>End Period</b>
General Government	
Central Bank	
Deposit-Taking Corporations, except the Central Bank	
Other Sectors	
Other Financial Corporations	
Nonfinancial corporations	
Households and nonprofit institutions serving households (NPISHs)	
Direct Investment: Intercompany Lending	
(from direct investors, direct investment enterprises, and fellow enterprises)	
Total Economy	

# F. External Debt by Creditor Sector

7.44 Tables 7.12 and 7.13 present external debt position data by creditor sector. Table 7.12 provides for the presentation of creditor sector data for five nonresident creditor sectors: multilateral organizations, general government (excluding multilateral organizations), central

#### **External Debt Statistics: Guide for Compilers and Users**

bank,<sup>13</sup> deposit-taking corporations, except the central bank, and other sectors. Traditionally, this information has been most readily available for nonnegotiable instruments and has been essential when undertaking debt-reorganization discussions. More broadly, information on creditor sectors has been compiled because different types of creditors may respond to changing circumstances differently, and this can have implications for the economic situation of an economy.

Table 7.12. Gross External Debt Position: By Debtor and Creditor Sectors						
		Ci	reditor Sectors	(End Period)		
	Multilateral Organizations 1/	General Government 1/2/	Central Bank 1/	Deposit-Taking Corporations, except the Central Bank	Other Sectors	Total
General Government						
Short-term 3/						
Long-term						
Central Bank						
Short-term 3/						
Long-term						
Deposit-taking Corporations, except the Central Bank						
Short-term 3/						
Long-term						
Other Sectors						
Short-term 3/						
Long-term						
Other financial corporations						
Short-term 3/						
Long-term						
Nonfinancial corporations						
Short-term 5/						
Households and nonprofit institutions serving households (NPISHs) Short-term 3/						
Long-term						
Gross External Debt Excluding Direct Investment						
Short-term						
Long-term						
Direct investment: Intercompany lending						
Debt liabilities of direct investment enterprises to direct investors						
Debt liabilities of direct investors to direct investment enterprises						
Debt habilities between fellow enterprises						
Gross External Debt						
1/ For the multilateral organizations, general government, and central ba	ink creditor sect	ors, short-terr	n lending, on a	an original maturi	ty basis, mag	y be
insignificant-under which circumstances a short-/long-term split may no	t be necessary.					
2/ Excluding multilateral organizations.						
3/ It is recommended that all currency and deposits be included in the sh	ort-term catego	ry unless deta	iled informati	on is available to i	nake the sho	ort-

3/ It is recommended that a term/long-term attribution.

7.45 Most economies may face practical difficulties in identifying owners of debt securities.<sup>14</sup> Economies might attribute the value of all debt securities to "other sectors" as the creditor sector. If so, this assumption should be clearly identified in any presentation of data because it may be only very broadly reliable: for instance, monetary authorities hold significant quantities of cross-border securities as part of their foreign exchange reserves. An alternative approach would be to have a separate column for debt securities and exclude holdings of such securities from all the "sector" columns, as presented in Table 7.13.

7.46 Table 7.12 can be rearranged and extended as appropriate. One possibility is to divide the creditor sector information between official and other creditors. The official creditors could be further subdivided by multilateral and official bilateral creditors, and the latter could distinguish between Paris Club member creditors and non-Paris Club creditors; the disaggregation is presented in Table 7.13. Also, official bilateral debt could be separated between concessional and nonconcessional debt.

<sup>&</sup>lt;sup>13</sup> This category excludes multilateral monetary institutions such as the IMF, which are included under multilateral organizations, but includes regional central banks.

<sup>&</sup>lt;sup>14</sup> Chapter 13 of the *Guide* discusses the compilation of debt securities.

7.47 Because direct investment liabilities do not fall naturally into this presentation, totals are drawn before and after direct investment: intercompany lending. In addition, the "other sectors" as creditor sectors are not subdivided into other financial corporations, nonfinancial corporations, and households and NPISHs, since this would create an additional degree of difficulty in obtaining this creditor information. On the other hand, as private sector capital flows increase, and these creditor sectors become more significant, there could be analytical interest in identifying their claims separately. In particular, if significant, separate identification of the other financial corporations could be presented.

	End Period
Public Sector External Debt 1/	
Multilateral creditors 2/	
Short-term	
Long-term	
Official bilateral creditors 2/	
Short-term	
Long-term	
Deposit-taking Corporations, except the Central Bank, creditors	
Short-term	
Long-term	
Other creditors	
Short-term	
Long-term	
Debt securities	
Short-term	
Long-term	
Publicly-Guaranteed Private Sector External Debt 1/	
Multilateral creditors 2/	
Short-term	
Long-term	
Official bilateral creditors 2/	
Short-term	
Long-term	
Deposit-taking Corporations, except the Central Bank, creditors	
Short-term	
Long-term	
Other creditors	
Short-term	
Long-term	
Debt securities	
Short-term	
Long-term	
Total	
Memorandum Items	
Paris Club member creditors	
Public Sector External Debt	
Short-term	
Long-term	
Publicly-Guaranteed Private Sector External Debt	
Short-term	
Long-term	
1/ It is recommended that all currency and deposits be included in the s	hort-term category unless detailed
information is available to make the short-term /long-term attribution	5,
2/For the multilateral organizations general government and central b	ank creditor sectors short-term lending

on an original maturity basis, may be insignificant-under which circumstances a short-/long-term split may not be necessary.

7.48 An alternative approach in terms of creditor sectors is presented in Table 7.13. This table provides for the presentation of data for four nonresident creditor sectors: multilateral creditors, official bilateral creditors, deposit-taking corporations, except the central bank, and other creditors, and debt securities are separately identified and excluded from the nonresident creditor sector of the securities' owner. The attribution of the debtor sector in this table is on a public sector basis, and Paris Club members' creditor data are separately identified in a memorandum item of the table.

## G. Net External Debt Position

7.49 As an economy increasingly integrates with the rest of the world, so analysis of the external liability position, and gross external debt position in particular, needs to take into account positions in external assets. Indeed, for risk-management purposes, entities may well manage external liabilities and assets in an integrated manner. On the other hand, there is difficulty in ascertaining the extent to which assets might be usable to meet outstanding debt liabilities. Table 7.14 provides a presentation of net external debt position data, placing gross external debt in the context of claims on nonresidents in the form of debt instruments.

Internal Cross External Assets in Debt Instruments         Net External Assets in Debt Instruments           General Government         (1)         (2)         (3)=(1)-(2)           Short-term         (1)         (2)         (3)=(1)-(2)           Gurnency and deposits 1/         (1)         (1)         (1)         (1)         (1)           Debt securities         (1)         (1)         (2)         (3)=(1)-(2)           Currency and deposits 1/         (1) <td< th=""><th>Table 7.14. Net External Debt Position: By Sector</th><th></th><th></th><th></th></td<>	Table 7.14. Net External Debt Position: By Sector			
Gross External Assets in Debt Position         Net External Debt         Net External Debt           Short-term         (1)         (2)         (3)=(1)-(2)           Gurrency and deposits 1/			End Period	
Debt InstrumentsDebt InstrumentsDebtShort-term(3)(3)=(1)-(2)Short-term		Gross External	External Assets in	Net External
General Government       Government         Short-term       Government         Currency and deposits 1/       Debt securities         Loans       Trade credit and advances         Thard bet habilities 2/3/       Na.         Unallocated gold accounts included in monetary gold 4/       n.a.         Soecial drawing rights (SDRs)       Government         Currency and deposits 1/       Debt securities         Loans       Trade credit and advances         Other debt liabilities 2/       Government         Central Bank       Short-term         Short-term       Government         Currency and deposits 1/       Debt securities         Loans       Trade credit and advances         Unallocated gold accounts included in monetary gold 4/       n.a.         Other debt liabilities 2/       Government         Loans       Trade credit and advances       Government         Unallocated gold accounts included in monetary gold 4/       n.a.       Government         Short-term       Government       Government       Government         Special drawing rights (SDRs)       Government       Government       Government         Currency and deposits 1/       Debt securities       Government       Governet       Governet       <		Debt Position	Debt Instruments (2)	Debt (3)=(1)-(2)
Short-termImage: Currency and deposits 1/Debt securitiesImage: Currency and deposits 1/LoansImage: Currency and deposits 1/Soecial drawing rights (SDRs)Image: Currency and deposits 1/Debt securitiesImage: Currency and deposits 1/Debt securitiesImage: Currency and deposits 1/Currency and deposits 1/Image: Currency and deposits 1/Debt securitiesImage: Currency and deposits 1/Cottrail BankImage: Currency and deposits 1/Short-termImage: Currency and deposits 1/Debt securitiesImage: Currency and deposits 1/ <td>General Government</td> <td></td> <td></td> <td></td>	General Government			
Currency and deposits 1/	Short-term			
Debt securitiesImage: Construction of the securitiesLoansImail: Construction of the securitiesOther debt liabilities 2/ 3/Imail: Construction of the securitiesSpecial drawing rights (SDRs)Imail: Construction of the securitiesCurrency and deposits 1/Imail: Construction of the securitiesDother debt liabilities 2/Imail: Construction of the securitiesConstruction of the securitiesImail: Construction of the securitiesConstruction of the securitiesImail: Construction of the securitiesConstruction of the securitiesImail: Construction of the securitiesCurrency and deposits 1/Imail: Construction of the securitiesCurrency and deposits 1/Imail: Construction of the securitiesLoansImail: Construction of the securitiesLoansImail: Construction of the securitiesImail: Construction of the securitiesImail: Construction of the securitiesLoansImail: Construction of the securitiesSpecial drawing rights (SDRs)Imail: Construction of the securitiesLoansImail: Construction of th	Currency and deposits 1/			
Loans       Image: credit and advances         Trade credit and advances       Image: credit and advances         Other debt liabilities 2/ 3/       Image: credit and advances         Currencv and deposits 1/       Image: credit and advances         Debt securities       Image: credit and advances         Contral Bank       Image: credit and advances         Short-term       Image: credit and advances         Currencv and deposits 1/       Image: credit and advances         Debt securities       Image: credit and advances         Loans       Image: credit and advances         Other debt liabilities 2/3/       Image: credit and advances         Unallocated gold accounts included in monetary gold 4/       n.a.         Other debt liabilities 2/3/       Image: credit and advances         Unallocated gold accounts included in monetary gold 4/       n.a.         Other debt liabilities 2/3/       Image: credit and advances         Unallocated gold accounts included in monetary gold 4/       n.a.         Other debt liabilities 2/3/       Image: credit and advances         Unallocated gold accounts included in monetary gold 4/       n.a.         Other debt liabilities 2/3/       Image: credit and advances         Debt securities       Image: credit and advances       Image: credit and advances	Debt securities			
Trade credit and advances       Imail: Constraint of the second sec	Loans			
Other debt liabilities 2/3/       n.a.         Long-term       n.a.         Special drawing rights (SDRs)       n.a.         Currency and deposits 1/       n.a.         Debt securities       n.a.         Loans       n.a.         Trade credit and advances       n.a.         Other debt liabilities 2/       n.a.         Central Bank       n.a.         Short-term       n.a.         Currency and deposits 1/       n.a.         Debt securities       n.a.         Loans       n.a.         Trade credit and advances       n.a.         Unallocated sold accounts included in monetary gold 4/       n.a.         Other debt liabilities 2/ 3/       n.a.         Unallocated sold accounts included in monetary gold 4/       n.a.         Other debt liabilities 2/3/       n.a.         Long-term       n.a.         Special drawing rights (SDRs)       n.a.         Currency and deposits 1/       n.a.         Debt securities       n.a.         Loans       n.a.         Trade credit and advances       n.a.         Other debt liabilities 2/       0.0         Deposit Taking Corporations, except the Central Bank       n.a.	Trade credit and advances			
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Trade credit and advances	Loans			
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Trade credit and advances       Image: Constraint of the securities         Other debt liabilities 2/3/       Image: Constraint of the securities         Currency and deposits 1/       Image: Constraint of the securities         Debt securities       Image: Constraint of the securities         Other Sectors       Image: Constraint of the securities         Short-term       Image: Constraint of the securities         Debt securities       Image: Constraint of the securities         Loans       Image: Constraint of the securities	Loans			
Other debt liabilities 2/3/	Trade credit and advances			
Long-term	Other debt liabilities 2/ 3/			
Currency and deposits 1/	Long-term			
Debt securities	Currency and deposits 1/			
Loans     Image: Constraint of the sectors       Other Sectors     Image: Constraint of the sector	Leave			
Other debt liabilities 2/	Loans Trade modit and advances			
Other Sectors	Other debt liabilities 2 /			
Short-term	Other Sectors			
Currency and deposits 1/	Short torm			
Debt securities	Short-term Currency and denosits 1/			
Loans	Debt securities			
Trade credit and advances	Trade credit and advances			
Other debt liabilities 2/3/	Other debt liabilities 2/3/			
Long-term	Long-term	1		
Currency and deposits 1/	Currency and denosits 1/	1		
Debt securities	Debt securities			
Loans	Loans			
Trade credit and advances	Trade credit and advances			
Other debt liabilities 2/	Other debt liabilities 2/			

## External Debt Statistics: Guide for Compilers and Users

Table 7.14. Net External Debt Position: By Sector (Continued)			
		End Period	
	Gross External	External Assets in	Net External
	Debt Position	Debt Instruments	Debt
	(1)	(2)	(3)=(1)-(2)
Other financial corporations			
Short-term			
Currency and deposits 1/			
Debt securities			
Loans			
Trade credit and advances			
Other debt liabilities 2/ 3/			
Long-term			
Currency and deposits 1/			
Debt securities			
Loans			
Trade credit and advances			
Other debt liabilities 2/			
Nonfinancial corporations			
Short-term			
Currency and deposits 1/			
Debt securities			
Loans			
Trade credit and advances			
Other debt liabilities 2/ 3/			
Long-term			
Currency and deposits 1/			
Debt securities			
Loans			
Trade credit and advances			
Other debt liabilities 2/			
Households and nonprofit institutions serving households			
(NPISHs)			
Short-term			
Currency and deposits 1/			
Debt securities			
Loans			
Trade credit and advances			
Other debt liabilities 2/ 3/			
Long-term			
Currency and deposits 1/			
Debt securities			
Loans			
Trade credit and advances			
Uther debt liabilities 2/			
Direct investment: Intercompany lending			
Debt liabilities of direct investment enterprises to direct investors			
Debt liabilities of direct investors to direct investment enterprises			
Debt liabilities between fellow enterprises			
Total (3)			

Table 7.14. Net External Debt Position: By Sector (Continued)			
		Position in Financial Derivatives	
Financial Derivatives		at End of	Period
Liabilities (4)			
General Government			
Forwards			
Options			
Central Bank			
Forwards			
Options			
Deposit-taking Corporations, except the Central Bank			
Forwards			
Options			
Other sectors			
Forwards			
Options			
Other financial corporations			
Forwards			
Options			
Nonfinancial corporations			
Forwards			
Options			
Households and nonprofit institutions serving households (I	NPISHs)		
Forwards	_		
Options			
Assets (5)			
General Government			
Forwards			
Options			
Central Bank			
Forwards			
Ontions			
Deposit-taking Corporations, except the Central Bank			
Forwards			
Ontions			
Other sectors			
Forwards			
Ontions			
Other financial cornorations			
Forwards			
Ontiona			
Nonfinancial corporations			
Forwarda			
Porwarus			
Uptions Households and nonprofit institutions serving households (	NDICHA		
Fousenoids and nonprofit institutions serving households (I	NF15H5J		
rorwards			
Uptions			
Net External Debt Position plus Financial Derivatives (6)			
(6)=(3)+(4)-(5)		ļ	
In.a. not applicable	1		

1/ It is recommended that all currency and deposits be included in the short-term category unless detailed information is available to make the short-term/long-term attribution.

2/ Other debt liabilities comprise insurance, pension, and standardized guarantees schemes, and other accounts payable-other in the IIP statement.

3/ Arrears are recorded in the original debt instrument rather than in other debt liabilities, short term.
4/ Monetary gold includes elements of a debt instrument (unallocated gold accounts) and a nondebt instrument (gold bullion). In principle, the gold bullion element of monetary gold should be excluded from the calculation of net external debt. However, in practice, the total amount of monetary gold may have to be used in the net external debt calculation because compilers may not be able to exclude the gold bullion element.

7.50 The rows in Table 7.14 are structured as in the gross external debt position table (Table 4.1), except for "unallocated gold accounts included in monetary gold", which are debt assets of the monetary authority (general government or central bank). The columns present gross external debt, gross external assets in debt instruments, and net debt position. A total of net external debt position plus the net financial derivatives position (this position is valued at market value and should include the position in financial derivatives held as reserve assets) is drawn at the bottom of the table. Because of their different characteristics, information distinguishing forwards (including futures and swaps) and options within financial derivatives is encouraged.<sup>15</sup>

7.51 The data on external assets in the form of debt instruments to be included in this table are the same as presented in the IIP, with short- and long-term defined on an original maturity basis. The net external debt position is equal to gross external debt less gross external assets in debt instruments.

7.52 Provided that debt securities are valued at market value, the net external debt position in this table equals the net IIP position, excluding all equity (equity shares and other equity) and investment fund shares assets and liabilities, all financial derivatives and ESOs assets and liabilities, and gold bullion.<sup>16</sup> While no memorandum item is provided for debt securities, if presented at nominal value in Table 7.14, additional data should be compiled on their market value (disaggregated by sector and maturity as presented in the memorandum item on debt securities to Table 4.1). This approach facilitates comparability with other macroeconomic statistics, including the IIP statement.

# H. Reconciliation of External Debt Positions and Flows

7.53 Between any two end-periods, the change in the gross external debt position can be disaggregated into component flows. These are financial transactions, valuation changes (exchange rate changes and other price changes), and other changes in volume. Such a disaggregation helps the compiler to reconcile and verify data, and it provides useful analytical information to the user of data (for example, the extent to which changes in the gross external debt position since the previous period are due to transactions, valuation changes, and/or revisions to the previous period data).

7.54 The reconciliation of gross external debt positions at two different reference dates is set out in Table 7.15. This presentation emphasizes how changes in the external debt position result from transactions, valuation changes, and other changes in volume during the reference period. In this table, the first column is the gross external debt position at the beginning of

<sup>&</sup>lt;sup>15</sup> Cross border liabilities in ESOs are likely to be insignificant compared to financial derivative positions and, if available, so can be included with financial derivatives (options). If significant, ESOs could be separately recorded under the appropriate institutional sector.

<sup>&</sup>lt;sup>16</sup> Monetary gold includes elements of a debt instrument (unallocated gold accounts) and a nondebt instrument (gold bullion). In principle, the gold bullion element of monetary gold should be excluded from the calculation of net debt. However, in practice, the total amount of monetary gold may have to be used in the net debt calculation because compilers may not be able to exclude the gold bullion element (*BPM6*, paragraphs 5.74-5.77).

the period, followed by the transactions during the period. Because the conceptual approach taken in the *Guide* is consistent with *BPM6*, the balance of payments transaction data can be used in the transactions column. The next two columns are valuation changes (holding gains and losses) on debt liabilities: exchange rate changes and other price changes<sup>17</sup>. These changes assume greater importance with increased volatility of prices in security and exchange rate markets. A nominal-valuation presentation of debt securities would exclude any changes in value arising from market prices. Before the position at the end of the period, a fifth item of "other changes in volume" is included. These changes include reclassifications of external debt such as when entities switch from one institutional sector to another, and when the nature of a debt instrument changes–an example being of an instrument moving from a specific type (say, a loan) to direct investment: intercompany lending, when the relationship between the creditor and debtor becomes that of direct investment.

Table 7.15. Gross External Debt Position: Reconciliation of Position	s and Flows					
	Position at		Changes in position due to			
	beginning of period	Transactions	Exchange rate changes	Other price changes	Other changes in volume	Position at end of period
General Government						
Short-term						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/3/						
Long-term						
Special drawing rights (SDRs). Allocation						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/						
Central Bank						
Short-term						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/ 3/						
Long-term						
Special drawing rights (SDRs), Allocation						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/						
Deposit-taking corporations, except the central bank						
Short-term						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/ 3/						
Long-term						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt habilities 2/		-				
Other Sectors						
Snort-term						
Currency and deposits 1/						
Debt securities						
Loans The desired it and a desired						
Trade credit and advances						
Uther dept habilities 2/ 3/						
Long-term						
Currency and deposits 1/						
Debt securities						
Loans The design different education						
I rade credit and advances						
Other dept liabilities 2/						

<sup>&</sup>lt;sup>17</sup> In addition to market price changes, this column covers other non-exchange-rate valuation changes-for example, changes in the value of pension fund liabilities to nonresident participants and policyholders arising from revaluations.

#### **External Debt Statistics: Guide for Compilers and Users**

Table 7.15. Gross External Debt Position: Reconciliation of Positions	ontinued)					
			Changes in po	sition due to		
	Position at beginning of period	Transactions	Exchange rate changes	Other price changes	Other changes in volume	Position at end of period
Other financial corporations						
Short-term						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/ 3/						
Long-term						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/						
Nonfinancial corporations						
Short-term						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/3/						
Long-term						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/						
Households and nonprofit institutions serving households (NPISHs)						
Short-term						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/ 3/						
Long-term						
Currency and deposits 1/						
Debt securities						
Loans						
Trade credit and advances						
Other debt liabilities 2/						
Direct investment: Intercompany lending						
Debt liabilities of direct investment enterprises to direct investors						
Debt liabilities of direct investors to direct investment enterprises						
Debt liabilities between fellow enterprises						
Gross External Debt						1
1/ It is recommended that all currency and deposits be included in the	short-term ca	tegory unless	detailed inf	ormation is a	vailable to n	ake the short-

2/ Other debt liabilities comprise insurance, pension, and standardized guarantees schemes, and other accounts payable-other in the IIP statement. 3/ Arrears are recorded in the original debt instrument rather than in other debt liabilities, short term.

### I. Debt Securities

#### **Reconciliation of Nominal and Market Value**

7.55 The *Guide* recommends that debt securities be valued in the gross external debt position at nominal and market value. While the market value takes into account fluctuations in market prices, the nominal value does not. Market prices change over time for a number of reasons, including changes in market interest rates, changes in investor perception of the

creditworthiness of the debtor, and changes in market structure (such as might affect market liquidity).

7.56 The divergence in the market and nominal value of debt securities at one moment in time, and over time, is of analytical value. For this reason, Table 7.16 provides a framework for reconciling nominal and market valuation of debt securities included in the gross external debt position. Debt securities are presented in the table broken down by institutional sector and maturity. It is intended that data be presented in absolute amounts in the same unit of account used to present the gross external debt position.

Table 7.16. Gross External Debt Position: Debt Securiti	esReconciliation o	f Nominal and Ma	arket Value
	Nominal Value Position at End of Period 1/	Difference with Market Value	Market Value Position at End of Period 1/
General Government			
Short-term			
Long-term			
Central Bank			
Short-term			
Long-term			
Deposit-taking Corporations, except the Central Bank			
Short-term			
Long-term			
Other Sectors			
Short-term			
Long-term			
Other financial corporations			
Short-term			
Long-term			
Nonfinancial corporations			
Short-term			
Long-term			
Households and nonprofit institutions serving			
householde (NPISHe)			
Short-term			
Long-term			
Total			
Short-term			
Long-term			
1/ Arrears (if applicable) are included in the original de	bt instrument.		

## Location of Debt Securities Issuance

7.57 Information on the location of issuance of debt securities issued by residents and owned by nonresidents can also be of analytical value. For instance, such data provide an indication of the motivation of debtors and creditors—whether residents are attracting foreign investors by issuing securities in their markets; and of possible liquidity risk—securities issued in international markets may be harder to refinance in the event of an external shock to the economy. In addition, in the absence of information on foreign currency debt, these data can provide a broad idea of the foreign currency/domestic currency attribution of debt securities-for instance, internationally issued debt is likely to be foreign-currency-linked. From a compilation viewpoint, data on securities issued in international markets might well be captured in a different manner from that of issues in the domestic market.

#### **External Debt Statistics: Guide for Compilers and Users**

A presentation for these data is provided in Table 7.17. The rows distinguish debt 7.58 securities issued by general government from those issued by all other sectors. The separate identification of government issues reflects the government's important and special role, in most economies, as a borrower. Depending on the extent of security issuance by the other institutional sectors, a further disaggregation of issues, such as for banks, might also be of analytical interest. The maturity attribution is on an original maturity basis, although the table can also be presented on a remaining maturity basis.

NonresidentsLocation of Issuance				
	End Period			
Domestically issued				
Short-term				
General government				
All other sectors				
Long-term				
General government				
All other sectors				
Internationally issued				
Short-term				
General government				
All other sectors				
Long-term				
General government				
All other sectors				
Total				

Table 7.17 Cross External Dobt Position, Posident-Issued Dobt Securities Owned by

Consistent with the concepts set out in the *Guide*, Table 7.17 only covers information 7.59 on nonresident ownership of resident-issued securities. However, there might also be interest in presenting data on resident as well as nonresident ownership of resident-issued securities, both in domestic and international markets. By including additional columns for residentand nonresident-owned securities, the table can be extended to cover such information.

## J. Cross-Border Trade-Related Credit

In addition to presenting data by type of instrument, another approach is to present 7.60 data by the type of use of the borrowing. In this regard, of special interest is information on cross-border trade-related credits by debtor and creditor sector-that is, credits that finance trade. Such credit is directly linked to activity in the real economy. Table 7.18 provides a model for presenting data on borrowing used to finance trade, with the disaggregation by, first, maturity (original basis) and, second, institutional sector. In presenting these data, tradebills could be separately identified, both because of the analytical interest in such data and to help with reconciliation with creditor-based statistics.

#### **Further Presentation Tables of External Debt**

Table 7.18. Gross External Debt Position:Cross-Border T	rade-Related (	Credit				
	Creditor Sector (End of Period)					
Debtor Sector	General Government	Deposit-taking Corporations, except the Central Bank 1/	Other Sectors	Direct Investment: Intercompany Lending	Total	
Short-term						
General Government				n.a.		
Central Bank				n.a.		
Deposit-Taking Corporations, except the Central Bank				n.a.		
Other Sectors				n.a.		
Direct Investment: Intercompany Lending	n.a.	n.a.	n.a.			
Long-term						
General Government				n.a.		
Central Bank				n.a.		
Deposit-Taking Corporations except the Central Bank				n.a.		
Other Sectors				n.a.		
Direct Investment: Intercompany Lending	n.a.	n.a.	n.a.			
Total						
n.a. not applicable						
1/ It is recommended that any crossborder trade-related	debt to centra	l banks be included w	ithin this ca	tegory, unless the cer	itral	

1/ It is recommended that any crossborder trade-related debt to central banks be included within this category, unless the central banks are significant creditors, in which instance, they should be separately identified.

7.61 The debtor sectors are presented in rows, and the creditor sectors in columns. The rows and column for direct investment: intercompany lending relate only to the provision of trade-related credit between affiliated parties—that is, those transactions classified under direct investment in the balance of payments, and not the provision of trade-related credit by unrelated parties to direct investment entities. The maturity attribution is on an original maturity basis.

# 8. **DEBT REORGANIZATION**

# A. Introduction

8.1 Debt-reorganization transactions are a feature of external debt activity (see Box 8.1). Economies sometimes face difficulties in meeting their external debt obligations, or debtors may want to change the repayment profile of their external obligations for different reasons, including reducing the risk of future payment difficulties or reducing the cost of borrowing. In this context, they may undertake debt restructuring and debt conversions. This chapter defines debt reorganization, discusses the various types of debt-reorganization operations, and provides guidance on how they affect the measurement of the gross external debt position. Further, this chapter defines debt relief and recommends the measurement and presentation of statistics on debt reduction, which is also defined.

8.2 Reference is made in the chapter to the recording of debt-reorganization transactions in the measured flow data of the balance of payments, the OECD's Development Assistance Committee (DAC) system, and the World Bank's Debtor Reporting System (DRS). Full details of such recording approaches are set out in *BPM6* (IMF, 2008)<sup>1</sup>, the OECD's Handbook for Reporting Debt Reorganization on the DAC Questionnaire (OECD, 2000)<sup>2</sup>, and the Debtor Reporting System Manual (World Bank, 2000).<sup>3</sup>

# **B.** Definitions

8.3 Debt reorganization (also referred to as debt restructuring) is defined as arrangements involving both the creditor and the debtor (and sometimes third parties) that alter the terms established for servicing an existing debt. Types of debt reorganization include debt forgiveness, rescheduling, refinancing, conversion, prepayments, and assumption. Governments are often involved in debt reorganization, as a debtor, creditor or guarantor, but debt reorganization can also involve the private sector, such as through debt exchanges.

8.4 A creditor can also reduce debt through debt write-offs—a unilateral action that arises, for instance, when the creditor regards a claim as unrecoverable, perhaps because of bankruptcy of the debtor, and so no longer carries it on its books. This is not debt reorganization as defined in the *Guide* because it does not involve a bilateral arrangement. Similarly, a failure by a debtor economy to honor its debt obligations (default, moratorium, etc.) is not debt reorganization.

8.5 Generally, debt reorganization is undertaken to provide some debt relief to the debtor and can address liquidity and/or sustainability problems arising from future and current

<sup>&</sup>lt;sup>1</sup> *BPM6* Appendix 2 discusses the various types of debt reorganization and how they are recorded in the balance of payments and the international investment position.

 $<sup>^{2}</sup>$  At the time of writing the *Guide*, OECD was in the process of converging the various sets of directives into one set.

<sup>&</sup>lt;sup>3</sup> See also Chapter 16.

payment obligations. Debt relief results where there is (1) a reduction in the present value of these debt-service obligations; and/or (2) a deferral of the payments due, thus providing smaller near-term debt-service obligations (this can be measured, in most cases, by an increase in the duration of these obligations; that is, payments become weighted more toward the latter part of the debt instrument's life). However, if debt reorganization results in changes in present value and duration that are countervailing in their impact on the debt burden, then there is no debt relief, unless the net impact is significant, such as could occur if there was a deep reduction in present value (together with small decrease in duration) or a sharp increase in duration (together with a small increase in present value).

8.6 *Debt reduction* is defined as the reduction in the nominal value of external debt arising from a debt-reorganization arrangement, excluding any payments of economic value made by the debtor to the creditor as part of the arrangement. This is the definition to be used for compiling data to be presented in Table 8.1—debt reduction arising from debt reorganization. Debt reduction in present value terms is defined as the reduction in the present value of debtservice obligations arising from a debt reorganization, as calculated by discounting the projected future payments of interest and principal both before and after the reorganization at a common interest rate and comparing the difference. To illustrate the difference between debt reduction and debt reduction in present value terms, if the contractual rate of interest is reduced with no impact on the nominal value of external debt, no debt reduction is recorded but there is debt reduction in present-value terms.

Table 8.1. Nominal Creditor Sectors	l Value Debt R	eduction	n Arising	g from De	ebt Reorga	nizations: by	Debtor and
Public sector exter	nal debt						
Of which:	Multilateral						
	Official bilate	eral					
	Commercial	bank 1/					
	Debt securit	ies					
Publicly-guarantee	ed private sect	or extern	al debt				
Of which:	Multilateral						
	Official bilate	eral					
	Commercial	bank 1/					
	Debt securit	ies					
Private sector exte	rnal debt not j	publicly g	guarante	eed			
Of which:	Multilateral						
	Official bilateral						
	Commercial bank 1/						
	Debt securit	ies					
Of which:							
Debt rescheduled	l and refinance	ed					
Public and publ	icly-guarantee	ed debt					
Private sector d	ebt not public	ly guaran	iteed				
Debt forgiven							
Public and publ	icly-guarantee	ed debt					
Private sector d	ebt not public	ly guaran	iteed				
Debt conversions	and prepaym	ents					
Public and publ	icly-guarantee	ed debt					
Private sector d	ebt not public	ly guaran	iteed				
Debt assumption							
Public and publ	icly-guarantee	ed debt					
Private sector d	ebt not public	ly guaran	iteed				
1 / Excluding debt	securities						
1, Encluding debt	securities.						

8.7 *Debt swaps* are exchanges of debt, such as loans or securities, for a new debt contract (debt-to-debt swaps), or exchanges of debt-for-equity, debt-for-exports, or debt-for-domestic currency, such as to be used for projects in the debtor country (also known as debt conversion).<sup>4</sup> This definition is intended to include debt-for-development swaps where economic value is provided by the debtor to the creditor for use in development projects in the debtor's economy.

## C. Types of Debt Reorganization

8.8 The four main types of debt reorganization are:

• A reduction in the amount of, or the extinguishing of, a debt obligation by the creditor via a contractual arrangement with the debtor. This is *debt forgiveness* as described in *BPM6* and the DRS and is also classified as debt forgiveness in the DAC system if it is in the framework of a bilateral agreement and there is a development/welfare motive.

<sup>&</sup>lt;sup>4</sup> A debt swap should be distinguished from a financial derivative swap. The financial derivative swap involves two parties agreeing to swap future cash flows, while a debt swap involves the exchange of the debt instrument itself for economic value.

- A change in the terms and conditions of the amount owed, which may result, or not, in a reduction in burden in present-value terms. Depending on the nature of the transaction undertaken, the reorganization is described as *debt rescheduling* or *refinancing* (or debt exchanges). Included are transactions that change the type of debt instrument owed—for example, loan for bond swaps—but not debt-forgiveness transactions.
- The creditor exchanges the debt claim for something of economic value, other than another debt claim, on the same debtor. This includes *debt conversion*, such as debt-for-equity swaps, debt-for-real-estate swaps, and debt-for-nature swaps,<sup>5</sup> and debt prepayment or debt buybacks for cash.
- A new debtor assumes the former debtor's outstanding liability to the creditor and is liable for repayment of the debt. This is *debt assumption* where a third party is also involved.

8.9 Debt-reorganization packages may involve more than one type; for example, most debtreorganization-packages involving debt forgiveness also result in a rescheduling of the part of the debt that is not forgiven or canceled.

8.10 For clarification purposes, in discussing the statistical treatment of debt reorganization, each of the four types of debt reorganization is considered separately. This has a number of advantages: each type of debt reorganization raises different statistical issues, hence encouraging a type-by-type approach; present international statistical guidelines, on which the guidelines in this chapter are based, are more advanced for some types of debt reorganization than for others; and there is interest in the different types of debt reorganization, and so there is an analytical benefit, where possible, in separately measuring and reporting any debt reduction resulting from their application.

#### **Debt Forgiveness**

8.11 Debt forgiveness is defined as the voluntary cancellation of all or part of a debt obligation within a contractual arrangement between a creditor in one economy and a debtor in another economy.<sup>6</sup> More specifically, the contractual arrangement cancels or forgives all or part of the principal amount outstanding, including interest arrears (interest that fell due in the past) and any other interest costs that have accrued. Debt forgiveness does not arise from the cancellation of future interest payments that have not yet fallen due and have not yet accrued.

8.12 If the debt reorganization effectively changes the contractual rate of interest—such as by reducing future interest payments but maintaining future principal payments, or vice versa—it

<sup>&</sup>lt;sup>5</sup> Some agreements described as debt swaps are equivalent to debt forgiveness from the creditor together with a commitment from the debtor country to undertake a number of development, environmental, etc., expenses. These transactions should be considered under the debt forgiveness, as counterpart funds are required by, but not provided to, the creditor.

<sup>&</sup>lt;sup>6</sup> This includes forgiveness of some or the entire principal amount of a credit-linked note due to an event affecting the entity on which the embedded credit derivative was written, and forgiveness of principal that arises when a type of event contractually specified in the debt contract occurs—for example, forgiveness in the event of a type of catastrophe.

is classified as debt rescheduling. However, in the specific instance of zero-coupon securities, a reduction in the principal amount to be paid at redemption to an amount that still exceeds the principal amount outstanding at the time the arrangement becomes effective could be classified as either an effective change in the contractual rate of interest, or as a reduction in principal with the contractual rate unchanged. Unless the bilateral agreement explicitly acknowledges a change in the contractual rate of interest (in which case the change should be recorded as debt rescheduling), such a reduction in the principal payment to be made at maturity should be recorded as debt forgiveness.

## **Recommended treatment**

## External debt position and debt reduction

8.13 Debt forgiveness reduces the gross external debt position by the value of the outstanding principal that has been forgiven. Any reduction in principal is recorded under the appropriate debt instrument when it is received—that is, when both the debtor and creditor record the forgiveness in their books. Where possible, debt forgiveness in nominal terms should be separately identified and recorded under debt reduction in Table 8.1.

8.14 If forgiveness relates to payments on debt obligations that are past due and are yet to be paid—that is, arrears of interest and principal—a reduction in the gross external debt position under the appropriate debt instrument is recorded. Forgiveness of interest costs that have accrued during the period or amounts disbursed in the current recording period has no impact on the gross external debt position at the end of the period because any increase in the outstanding value of the debt instrument is matched by the debt forgiveness. However, any such forgiveness should be reported under debt reduction in Table 8.1.

8.15 A special case of debt forgiveness is where the creditor provides a grant to the debtor that is used to pay the debt-service payments as they fall due. In such instances, the gross external debt position is only affected when debt-service payments are made—that is, the same as for all debt instruments being serviced. Nonetheless, such assistance is recorded in the table as debt reduction when the debt-service payments are made.

## Flow data

8.16 In flow terms, debt forgiveness is recorded in the balance of payments as a capital transfer receipt of the debtor economy (capital transfer payment of the creditor economy), and in the DAC and DRS systems as a debt-forgiveness grant. The counterpart transaction in the balance of payments and DAC is an offsetting entry for the amount of principal owed. When debt forgiveness is in the form of a grant by the creditor to the debtor (as in the previous paragraph), no transaction is recorded in the DRS; the amount forgiven is reflected as a reduction in the position data.

## **Debt Rescheduling and Refinancing**

8.17 Debt rescheduling and refinancing involve a change in an existing debt contract and/or replacement by a new debt contract, generally with extended debt service payments.<sup>7</sup> Debt rescheduling is a bilateral arrangement between the debtor and the creditor that constitutes a formal deferment of debt-service payments and the application of new and extended maturities to the deferred amount. This is achieved through a change of the terms and conditions of the existing contracts. The new terms of rescheduling normally include one or more of the following elements: extending repayment periods, reductions in the contracted interest rate, adding or extending grace periods for the repayment of principal, fixing the exchange rate at favorable levels for foreign currency debt, and rescheduling the payment of arrears, if any. Rescheduling may or may not result in a reduction in the present value of debt, as calculated by discounting the old and new payment schedule by a common interest rate.

8.18 Refinancing of a debt liability involves the replacement (in full or partial) of an existing debt instrument or instruments, including arrears, with a new debt instrument or instruments. For instance, the public sector may convert various export credit debt it is owed into a single loan. Refinancing may involve the exchange of one type of debt instrument, such as a loan, for another, such as a bond. Some debt-refinancing arrangements feature new money facilities (see below, paragraph 8.54). Also, refinancing can be said to have taken place when countries with private sector bond creditors exchange existing bonds for new bonds through exchange offers (rather than a change in terms and conditions).

8.19 Rescheduling (for instance, under a Paris Club agreement) can be characterized as flow or stock rescheduling. A flow rescheduling typically refers to a rescheduling of specified debt service falling due during a certain period and, in some cases, of specified arrears outstanding at the beginning of that period. A stock rescheduling involves principal payments that are not yet due, and arrears, if any, and like a flow rescheduling, can include both an element of debt forgiveness and a rescheduling of the amounts not reduced.<sup>8</sup>

8.20 Debt service moratorium extended by creditors is a special case of debt rescheduling that involves an individual creditor permitting the debtor a formal suspension of debt service payments falling due within a given period. Debt service moratorium may be granted in the event of natural disasters, such as the moratorium granted to tsunami-affected countries in 2005, and usually involves formal exchange of letters but not necessarily a formal bilateral agreement. As the intention of the action is to provide the debtor with short-term debt relief, debt service moratorium extended by creditors should be classified as debt rescheduling, provided there is some formal process that demonstrates agreement on behalf of both the debtor and creditor, such as the exchange of letters, to delay payment. In such instances, arrears are not created.

8.21 Debt service falling due between Paris Club agreed minute date and specified implementation date is another special case of debt rescheduling. Under Paris Club debt

<sup>&</sup>lt;sup>7</sup> Debt rescheduling may involve a new debt contract or an amendment to the existing debt contract that changes the debt-service payments schedule.

<sup>&</sup>lt;sup>8</sup> Flow treatments aim at closing the debtor country's financing gap. Stock treatments apply not only to the payments due over a given period of time, but to the entire position of certain debts. The aim of agreements covering debt positions is to provide a country with a final Paris Club treatment (called an "exit treatment").

rescheduling arrangements, creditor countries as a group usually agree in the nonbinding "Agreed Minute" that they sign, that payment terms and conditions of applicable debt falling due before the specified effective (implementation) date of the Paris Club bilateral agreement might not be paid on schedule. However, interest continues to accrue based on the existing loan terms, but payments are not made, up until the point when there is a formal bilateral agreement. When such payments fall due, they are considered technical arrears (see paragraph 3.44) and are treated in the debtor economy as rescheduled short-term debt.

## **Recommended treatment**

## External debt position

8.22 Any agreed change in the terms of a debt instrument is to be recorded as the creation of a new debt instrument, with the original debt extinguished at the time both parties record the change in terms in their books. If no precise time is determined, the time at which the creditor records the changes in its books is decisive. If the rescheduling of obligations due beyond the current period is linked to the fulfillment of certain conditions by the time the obligations fall due (such as multiyear Paris Club rescheduling), entries are recorded only in the period when the specified conditions are met. Whether the gross external debt position—both under debt rescheduling and debt refinancing— increases, decreases, or remains unchanged depends on whether the value of the new instrument(s) is respectively greater than, smaller than, or the same as the original debts being replaced—this is the case regardless of the valuation method employed to measure external debt instruments.<sup>9</sup> In other words, both before and after a debt rescheduling, the value of the gross external debt position is simply determined by the value of outstanding external debt liabilities of residents owed to nonresidents at the reference date.

8.23 As explained in Chapter 2, and as the examples in that chapter illustrated, the stock of external debt at any moment in time can be calculated by discounting future payments at a specified rate of interest. This interest rate can be the contractual rate (for nominal value), or a market rate for the specific borrower (for market value), or another rate. Using these different rates to discount payments will provide different position data for the same payment schedule. Debt reduction in present-value terms arising from rescheduling might be calculated using any of these rates—in the HIPC Initiative, a market-based rate is used.

8.24 If, as part of official and private debt-reduction packages, loans denominated in foreign currency are swapped for debt securities denominated in the domestic currency, the difference between the value of the loan and the value of the debt security in the domestic currency will be reflected in the gross external debt position. The extinguishment of the old debt liability, the loan, results in a decrease in the value of short-term or long-term loans, as appropriate, while an increase in debt securities is recorded.

# Flow data

<sup>&</sup>lt;sup>9</sup> If external debt is lower or higher because at the time of rescheduling it was agreed between the debtor and creditor that the amount of late interest on arrears was to be more or less than that which accrued, back data of the gross external debt position should not be revised to reflect this agreement, provided that the accrual of interest costs on arrears in past periods was in line with the contract(s) that existed at that time.

8.25 In the transaction data in the balance of payments, both the extinguishment of the old debt liability and the creation of the new debt(s) are recorded. In the DAC system these flows are also recorded, except when the category of debt does not change, in which case only the capitalization of interest gives rise to a new flow. The DRS does not record these transactions in flow data (but they are reflected in the position data). In the balance of payments, the transaction is recorded at the value of the new debt instrument and any difference between the value of the old and new debts is treated as a valuation change<sup>10</sup>, such as in the case of exchanges of Brady bonds (see Box 8.1) for new global bonds. However when nonmarketable debt owed to official creditors is involved, any reduction in the nominal value of debt is recorded as debt forgiveness (see above).<sup>11</sup>

<sup>&</sup>lt;sup>10</sup> Both the integrated IIP statement and the integrated external debt position statement (i.e., the statement that emphasizes how changes in the position result from valuation changes, and other changes in volume during the reference period—see Table 7.16), reflect the transactions extinguishing the old debt instrument and creating the new debt instrument along with any valuation change recorded as revaluations.

<sup>&</sup>lt;sup>11</sup> See *BPM6*, paragraphs A2.12 – A2.13 and A2.16-A2.19.

#### Box 8.1. Sovereign Debt Restructuring with Private Creditors\*

Sovereign debt restructurings have been a pervasive phenomenon, amounting to more than 600 cases in 95 countries between 1950 and 2010. One third of these external debt restructurings were debt exchanges with private creditors (commercial banks and bondholders) and about two thirds have been Paris Club agreements for official bilateral debt (see Box 8.2). There have also been debt restructuring operations under the HIPC and MDRI initiatives which provided extensive relief and debt forgiveness (see Appendix V).

-	Sovereign Del	bt Restructuring by T	Type of Creditor					
	Private (	Creditors	Official Creditors					
Creditor	Commercial Banks	Bondholders	Bilateral (Governments)	Multilateral (World Bank, IMF)				
Restructuring Vehicle	London Club (Creditor Committees)	Exchange offers	Paris Club	Preferential Treatment; Restructuring only for poorest countries				

Ninety percent of the debt exchanges with private creditors affected bank loans while the remaining ten percent were sovereign bond restructurings.

The process of debt renegotiations between governments and commercial banks is typically labeled as "London Club" restructuring (see Box 8.2). Despite its name, the London Club is neither a statutory institution based in London nor a well-organized club. Instead, the term loosely describes the case-by-case restructuring routine developed between major Western banks and developing country governments in the late 1970s and early 1980s. Notwithstanding legal, coordination, and logistical issues, holdouts, and intercreditor disputes, there have been more than 100 restructurings between 1980 and 1990 under the umbrella of the London Club.

The Brady Plan was launched in March 1989 to address debtor insolvency and commercial bank exposure. The plan signaled a shift in the official policy stance on debt restructuring from short-term relief to face value reductions in debt to restore debtor solvency. It had three key elements: first, banks exchanged their loans for sovereign bonds; second, creditors were offered a menu of options in respect of instruments with different terms and implications for NPV and face value reductions; and third, it provided for the capitalization of the interest arrears that were not written off by commercial banks. There were 17 deals (mostly in Latin America) between 1989 and 1997 under this plan; debtor countries normalized their relations with creditors and the agreements also allowed them to regain access to capital markets.

#### Sovereign Bond Restructuring

The restructuring of a country's sovereign bonded external debt (Eurobonds and Brady bonds) began with Pakistan at the end of 1999, following the extension of the "comparability of treatment" principle to bondholders in Pakistan's agreement with the Paris Club in January 1999. A new generation of sovereign bond debt restructurings has since extended to a number of emerging market countries such as Ukraine (2000), Russia (2000), Ecuador (2000 and 2009), Moldova (2002), Uruguay (2003), Dominica (2004), Argentina (2005), Dominican Republic (2005), Grenada (2005), Belize (2007), Seychelles (2010), and Cote D'Ivoire (2010).

Sovereign bonds are typically restructured through an exchange offer. This involves identifying bond holders, verifying their claims, preparing an exchange offer, most likely after consultation with the bondholders, launching the exchange offer, waiting for bondholder participation, and exchanging the debt.

In terms of restructuring debt, sovereign bonds have a number of characteristics that distinguish them from other types of debt instruments.

• First, there is usually a wider range of investors than for nonnegotiable external debt instruments, and hence various investor groups all with potentially different investment motivations. For instance, the investment motivations of retail—nonfinancial institution—investors may be different from those of financial institutions.

• Second, market prices are invariably quoted. Thus, those investors that mark-to-market frequently—having borne the market-value loss in the secondary market price of the to-be-exchanged bonds, or having purchased at a low market value—might well compare the present value of the exchange offered (discounting payments at a particular interest rate) with the current market price of the to-be-exchanged bonds. In the simplest case, if the present value of the exchange bond is higher than the market price of the original bond, the holder of the to-be-exchanged bond has an incentive to tender his bonds in the exchange.

• Finally, most Eurobonds have cross-default clauses or cross-acceleration clauses in their covenants, thus perhaps making it impossible for a sovereign debtor to pick and choose which bond-holders are repaid and which are not. So, markets debate the issue of whether a restructuring of external bonded debt needs to be comprehensive across other foreign currency debt instruments as well.

The consequence of the above is that successful bond restructuring—mostly bond exchanges—has involved the debtors exchanging securities at a premium to the market price, although well below the face value, or providing other "sweeteners" to encourage bondholders to participate. Bonds with the larger percentage of retail investors have tended to pay a higher premium. But, as with creditors for other types of debt instruments, a key consideration of creditors in any restructuring is whether the sovereign borrower is facing a liquidity or solvency problem, or neither.

Sovereign bond restructurings have not always been smooth, and in some cases negotiations have been protracted. It is often argued that the presence of Collective Action Clauses (CACs) can facilitate creditor-debtor negotiations in a restructuring situation, since they reduce the hurdle of having to achieve unanimity on a restructuring agreement (via the majority restructuring clause) and can limit the potential threat of litigation from "holdout" creditors. However, the actual use of CACs in past debt restructurings shows mixed results (see Das, Papaioannou, and Trebesch (2012)) .CACs specify how creditors are represented in negotiations, define majority voting procedures to alter the financial terms of the outstanding instruments, and can limit the incentive or ability of individual creditors to initiate litigation against the debtor. The use of CACs is now a well-established market practice for international bond issues.

\* This box is mainly based on Das, Papaioannou, and Trebesch (2012), "Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts", IMF WP 12/203.

#### Debt reduction

8.26 The *Guide* recommends that debt reduction arising from debt rescheduling and debt refinancing—that is, a reduction in the nominal amount outstanding, excluding any external debt-service payments made by the debtor as part of the arrangement—be measured and presented as in the debt-reduction table provided in this chapter. If the new external debt liability is denominated in a different currency from that of the external debt liability it is replacing, then any debt reduction should be determined using the market exchange rate between the two currencies prevailing on the transaction date (that is, the midpoint between the buying and selling spot rates).

8.27 In many instances of debt rescheduling, the method by which debt relief is provided is more complex than a simple reduction in nominal amount outstanding. For instance, a debt might be rescheduled with the same nominal value but with a lower interest rate or with extended maturities. By simply comparing the nominal amounts outstanding before and after the rescheduling, no debt reduction would be evident, but there may be debt reduction in present value terms, calculated by discounting future debt-service payments, both on the old and new debts, at a common rate. In such circumstances, a key issue is which rate to use: in debt-reorganization operations such as those under the HIPC Initiative and similar arrangements, debt reduction in present-value terms is calculated using an interest rate equal to a market-based so-called risk-neutral rate-such as the OECD's Commercial Interest Reference Rates (CIRRs).<sup>12</sup> In other cases, debt reduction in present value may be based on a rate that includes a risk premium, reflecting the creditor's assessment of the value of the claim (this is generally the case for the restructuring of claims held by private creditors).

8.28 Also, in some debt rescheduling, such as with concessional Paris Club agreements (Box 8.2), creditors are offered a choice between different options, one of them being a partial debt reduction, the other one being a rescheduling at a reduced interest rate (debt reduction in present value terms). Some creditors may forgive part of the claims and reschedule the outstanding part at the appropriate market rate ("debt-reduction" option), whereas other creditors reschedule the whole claim at a lower interest rate ("debt-service-reduction" option), resulting in a debt reduction in present value equivalent to the one granted by creditors that chose the "debt-reduction" option. Table 8.2 shows the variety and evolution of Paris Club debt-rescheduling terms.

<sup>&</sup>lt;sup>12</sup> These rates are determined monthly for 15 currencies on the basis of secondary market yields on government bonds. These data are published monthly on the Internet at: http://www.oecd.org/. For the HIPC Initiative, debt denominated in currencies for which no CIRR is available, if the currency is pegged to another currency such as the U.S. dollar, the CIRR for the latter should be used; in the absence of an exchange rate arrangement, as well as for the units of account used by various multilateral institutions, the SDR CIRR should be applied.

Income Countrie Countrie Niddie Countrie Niddie Countrie New TermsImage Terms	Table 8.2. Evolution of Paris Club Rescheduling Terms																			
Income function: funct	Lov								v-Income Countries <sup>2</sup>											
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Source: Paris Club. <sup>1</sup> Since the 1992 agreements with Argentina and Brazil, creditors have made increasing use of graduated payments schedules (up to 15 years' maturity and 2-3 years' grace for middle-income countries; up to 18years' maturity for lower-middle-income countries). <sup>2</sup> DR refers to the debt-reduction option; DSR to the debt-service-reduction option; CMI denotes the capitalization of moratorium interest; LM denotes the nonconcessional option providing longer maturities.Under London, Naples, and Lyon terms, there is a provision for a stock-of-debt operation, but no such operation took place under London terms. <sup>3</sup> These have also been called "Enhanced Toronto" and "Enhanced Concessionality; countries with a per capita income of more than \$500, and an overall indebtedness ratio on present-value loans of less than 350percent of exports may receive a 50 percent level of concessionality, terms are equal to London terms, except for the DSR option undera stock-of- <sup>5</sup> These terms are to be granted in the context of concert action by all creditors under the HIPC Initiative.They also include, on a voluntary basis, an official development assistance (ODA) debt-reduction option. <sup>6</sup> Fourteen years before June 1992. <sup>7</sup> Interest rates are based on market rates (M) and are determined in the bilateral agreements implementing the Paris Club Agreed Minute. R = reduced rates. <sup>8</sup> The interest rate was 3.5 percentage points below the market rate or half of the market rate if the market rate was below 7 percent.	Maturity (in years)	10	20	25	25	25	30	30	30	25	40	40	40	40	40	40	40	40	40	
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$^{12}$ The reduction of present value depends on the reduction in interest rates and therefore varies. See featnets 9	<sup>12</sup> The reduction of p	recent value	e depende on t	the re	ductio	n in is	terec	t rate	and	theref	Fore 1	aries See	footnet	. 8						

#### Box 8.2. Paris Club and Commercial Bank Debt Relief

The Paris Club has developed procedures for the collective rescheduling of official bilateral debt since the 1950s, when Argentina approached bilateral creditors. Between 1956 and 2011, over 420 agreements were reached with 88 different countries, and debt treated in the framework of Paris Club agreements amounted to \$ 553 billion. The Paris Club is an ad hoc organization of creditor countries (mainly OECD members) that responds to requests for debt relief with respect to debt owed (contracted or guaranteed) by the government and/or the public sector of the debtor country to creditor countries or their appropriate institutions: officially guaranteed export credits and bilateral loans.

Debts to Paris Club official creditors are generally restructured through the Paris Club. Debts to commercial banks are typically restructured through consortia of commercial banks (often called London Club). Noninsured supplier credits and debts to governments that do not participate in the Paris Club are normally restructured through bilateral negotiations.

#### **Paris Club**

The French Treasury maintains a permanent secretariat, and a senior official serves as chairman. There are 19 permanent members; nonmember creditor countries may be invited to take part in meetings for the treatment of the debt of a specific debtor country if they have significant claims on that country. The Club meets virtually every month in Paris, both for discussion of debt issues among the permanent members and for the restructuring of the debt of a specific debtor country.

Two types of "treatment" may be implemented by the Paris Club:

• A flow treatment of usually both scheduled amortization and interest payments falling due during the consolidation period— the period over which debt relief will be given; and

• A stock treatment of the outstanding principal at a given date.

Paris Club negotiations result in a multilateral framework agreement (Agreed Minute), which must be followed up with bilateral implementing agreements with each creditor.

At the beginning of the debt-relief process, Paris Club creditor countries will establish a "cut-off date." This means that all loan contracts signed after that date normally will not be eligible for debt relief by the Paris Club. The aim is to help the debtor country reestablish its creditworthiness by paying new obligations on their original schedules. Even though debt relief may extend over many years through a succession of Paris Club agreements, the cutoff date will usually remain unchanged, although under the Evian approach–see ahead–this policy is evolving.

It was increasingly recognized in the 1980s that some low-income countries with high external debt were facing solvency as well as liquidity problems. Over the years, the Paris Club has provided increasingly concessional rescheduling terms to low-income countries. The level of debt reduction on commercial claims was gradually increased from Toronto terms (1988—33.33 percent debt reduction) to London terms (1991—50 percent debt reduction) to Naples terms (1995—50 percent to 67 percent debt reduction) to Lyon terms (1996—80 percent debt reduction) and to Cologne terms (1999—90 percent reduction or more if needed under the HIPC Initiative). The evolution of Paris Club terms up to Lyon terms is presented in Table 8.2.

In 1996, the debt initiative for heavily indebted poor countries (HIPCs) was established, leading for the first time to multilateral creditors providing debt relief to a country. The Paris Club provides its debt-relief effort in the context of the HIPC Initiative through the use initially of Lyon terms, and now of Cologne terms. The HIPC Initiative demonstrated the need for creditors to take a more tailored approach when deciding on debt treatment for debtor countries. In October 2003, Paris Club creditors adopted the "Evian Approach" with the aim of tailoring treatments to the need of non-HIPC debtors.

A country benefiting from Paris Club debt relief commits to seek at least similar restructuring terms from its other external creditors (other than multilateral creditors, which only provide debt relief to countries eligible for assistance under the HIPC Initiative; non-HIPC debtors are not expected to seek comparable

treatment). This applies to non-Paris Club bilateral creditors, who generally negotiate with the debtor country on a bilateral basis, as well as private creditors (suppliers, banks, bondholders, etc.).

Paris Club agreements may include a debt-swap provision, within a limit usually set at 20 percent of commercial claims. Paris Club creditors on a bilateral basis conduct debt-swap operations.

#### **Commercial Bank Debt Relief**

Multilateral debt relief is much more difficult to organize for commercial banks than for official creditors. While a national export credit insurer can negotiate on behalf of any individual creditor, there is no way to consolidate national commercial bank claims. Rather, each creditor bank must approve the resulting agreement and, for loan syndication, the number is often in the hundreds.

The pattern of negotiations was established in a 1970 agreement between the Philippines and its commercial bank creditors. Creditor banks form a committee (sometimes known as the London Club) of about a dozen people who represent the major creditor banks. The composition of the committee—which can be completely different from case to case—takes into account the nationality of the banks in the consortium so that the negotiations can make provision for the different tax and regulatory systems that affect banks of different countries. The committee negotiates an "agreement in principle" with debtor country representatives. After all creditor banks approve this agreement, it is signed. It takes effect when certain requirements are met, such as payment of fees and of arrears. As with the rescheduling of debts to official creditors, banks provide debt relief normally in the context of a debtor country's adjustment program supported by an IMF arrangement. Unlike with Paris Club creditors, there is no "cut-off" date.

Commercial bank agreements restructure principal; consolidation of original interest costs is rare. Like Paris Club agreements, consolidation of short-term debt is also unusual (but when a major portion of arrears has arisen from short-term debt, there is often no option but to restructure). Among the initiatives for reducing the commercial debt burden was the Brady Plan (1989).

8.29 Because of the complexities involved, and the different interest rates that may be employed, international statistical standards have not developed to the point where there is general agreement on how to measure and make comparable the different methods of providing debt reduction in present-value terms.

8.30 Given the above, the *Guide* provides no recommended guidance on measuring and presenting debt reduction in present-value terms. Nonetheless, economies that undergo debt rescheduling and refinancing are encouraged to disseminate (1) the total nominal amounts involved; (2) the amount of debt reduction in present-value terms they have achieved—the difference between the present values (using a common interest rate) of the rescheduled/ refinanced debt-service payments before and after rescheduling/refinancing (present-value method);<sup>13</sup> and (3) provide detailed information on how the amount of the present-value reduction was calculated, including the interest rate(s) used.

8.31 Similarly, no guidance is provided for measuring debt relief in terms of an increase in duration because of the difficulty in measuring such relief and presenting it in a manner that is comparable with other forms of debt reorganization.

<sup>&</sup>lt;sup>13</sup> The payment schedule for both the original and rescheduled debt could also be provided as memorandum information.

## **Debt Conversion and Debt Prepayments**

8.32 External debt conversion is an exchange of debt—typically at a discount—for a nonexternal debt claim, such as equity, or for counterpart funds that can be used to finance a particular project or policy. Debt-for-equity, debt-for-nature, and debt-for-development swaps are all examples of debt conversion. A debt prepayment is the repurchase, usually at a discount (in which case prepayments are referred to as buybacks), by a debtor economy (or on its behalf) of all or part of its external debt. It may be undertaken on the secondary market or through negotiations with creditors.

## **Debt conversion**

8.33 Rather than exchanging debt for debt, countries might enter into a debt conversion process—the legal and financial transformation of an economy's liability. Typically, debt conversions involve an exchange of external debt in foreign currency for a nondebt obligation in domestic currency, at a discount. In essence, external debt is prepaid, and the nature of the claim on the economy is changed. An example is a foreign currency debt-for-equity swap, which results in debt claims on the debtor economy being reduced, and nonresident investments in equity investments increased. Debt-for-equity swaps often involve a third party, usually a nongovernmental organization or a corporation, which buys the claims from the creditor and receives shares in a corporation or local currency (to be used for equity investment) from the debtor. Other types of debt swaps such as external debt obligations for exports (debt for exports), or external debt obligations for counterpart assets that are provided by the debtor to the creditor for a specified purpose such as wildlife protection, health, education, and environmental conservation (debt for sustainable development), are also debt conversions.

## **Prepayments and buybacks**

8.34 Prepayments consist of a repurchase, or early payment, of debt at conditions that are agreed between the debtor and the creditor; that is, debt is extinguished in return for a cash payment agreed between the debtor and the creditor. When a discount is involved relative to the nominal value of the debt, prepayments are referred to as buybacks. In addition, debtors may enter the secondary market and repurchase their own debt because market conditions are such that it is advantageous financially to do so. However, debt reduction arising from this latter type of buyback is not consider debt reorganization and should not be recorded in the debt reduction Table 8.1 unless the transaction is agreed between the debtor and the creditor (see paragraph 8.39 below).

## **Recommended treatment**

## External debt position

8.35 For both debt conversions and debt prepayments, a reduction in the gross external debt position is recorded to the value of the debt instruments that are extinguished, irrespective of the value of the counterpart claim (or assets) being provided. This reduction in gross external debt position should be recorded at the time when the debt instrument is extinguished; more accurately, the gross external debt position no longer includes debt that has ceased to exist.

### Flow data

8.36 In the transaction data in the balance of payments, the reduction in the outstanding debt instrument is recorded at the value of the counterpart claim (or assets). Any difference between the value of the debt being extinguished and the corresponding claims or funds provided is recorded as a valuation change in position data in the integrated IIP statement (as well as in the integrated external debt position statement-the statement that emphasizes how changes in the position result from transactions, valuation changes, and other changes in volume during the reference period—see Table 7.16). For instance, if the market value of the equity is lower that the value of the old debt, a valuation adjustment is recorded in the integrated position statement under the instrument that is being extinguished. An exception arises when nonmarketable debt owed to official creditors is involved, and the counterpart claim (assets) has a lower value than the debt, in which instance both the debt instrument and the counterpart claim (or assets) are separately valued, and any difference in value is recorded as debt forgiveness (a capital transfer) in the balance of payments. The DAC system employs a similar approach, except that all differences in value are classified as transactions and not as valuation changes provided that they are the result of bilateral negotiation and there is a development motive for the operation. The DRS records both the reduction in the nominal value of the debt instrument and the value at which the debt was repurchased, allowing the discount to be measured.

## Debt reduction

8.37 Where official debt is exchanged for equity or counterpart funds to be used for development purposes, the difference between the value of the debt being extinguished and the counterpart claim or funds provided is classified as debt reduction.<sup>14</sup> This includes cases where the buyback of debt is by a third party, such as a nongovernmental organization or a corporation, which then sells the debt back to the debtor at a discount, under a deal that is arranged under a bilateral arrangement between debtor and government creditor.

8.38 In other cases, replacing a debt instrument with another type of claim may only be the recognition of reality. In other words, and particularly for marketable instruments, the price at which the debtor is willing to repurchase the debt may be greater than the price at which the debt previously traded. So, if the creditor purchased the security at the lower market price, the creditor might be making a holding gain.

8.39 The *Guide* recommends that in measuring and presenting data on debt reduction from such transactions, a distinction is made between (1) collaborative arrangements arising from discussions between the creditor(s) and debtor; and (2) buybacks that are initiated by the debtor through purchases in the secondary market. When buybacks arise from collaborative arrangements, any difference between the value of the counterpart claims (or assets) provided by the debtor and the nominal amount bought back should be recorded as debt reduction in

<sup>&</sup>lt;sup>14</sup> In the DAC system it is classified as other action on debt, and in the DRS it is classified as debt reduction.

Table 8.1. Debt reduction arising from buybacks in the secondary market initiated by the debtor should not be recorded as debt reduction in the table.<sup>15</sup>

8.40 For both public and private sector transactions, if external debt and the counterpart claims (or assets) are denominated in different currencies, any debt reduction should be determined using the market exchange rate between the two currencies prevailing on the transaction date (the midpoint between the buying and selling spot rates).

# **Debt Assumption**

8.41 Debt assumption is a trilateral agreement between a creditor, a former debtor, and a new debtor under which the new debtor assumes the former debtor's outstanding liability to the creditor and is liable for repayment of the debt. The activation of a guarantee is an example of debt assumption. If the original debtor defaults on its debt obligations, the creditor may invoke the contract conditions permitting the guarantee from the guarantor to be called. The guarantor unit then must either repay the debt or assume responsibility for the debt as the primary debtor and the liability of the original debtor is extinguished. Governments can be the debtor that is defaulting or the guarantor—the unit that must assume responsibility for the debt in case of default.

# **Recommended treatment**

# External debt position and debt reduction

8.42 Debt assumption is recorded in—the transaction and position data—when the creditor invokes the contract conditions permitting a guarantee to be called. If debt assumption arises under other circumstances, it is recorded when the liability is actually removed from the debtor's balance sheet, and the corresponding entries made in the new debtor's balance sheet, and not necessarily the time when agreement was reached to make the debt assumption. The recording by the entity assuming the debt has to be made in one time period: the successive dates of repayment previously foreseen in the context of the former debt are not relevant.

8.43 After it has been assumed, the debt, which was originally a liability of the former debtor, becomes a liability of the new debtor. The debt may carry the same terms as the original debt, or new terms may come into force because the guarantee was invoked. The amount to be recorded by the new debtor is the full amount of the outstanding debt that is assumed. No debt reduction is recorded, unless there is an agreement with the creditor to reduce the external debt. The recording of positions depends on whether the two entities—the entity assuming the debt and the original debtor—are located in the same economy or not, and whether or not the entity that assumes the debt receives a financial claim on the original debtor in respect of the debt that has been assumed. In many cases it is likely that the entity assuming the debt and the original debtor are resident in the same economy. If the original and new debtors are from different institutional sectors in the same economy, the external debt of the institutional sector of the

<sup>&</sup>lt;sup>15</sup> Only debt buybacks that are part of a comprehensive debt treatment and that meet certain criteria can be recorded as ODA in DAC statistics. Any discount provided in standalone buybacks are not reportable as ODA.

original debtor is reduced, and the external debt of the institutional sector of the new debtor increased; however, the gross external debt position of the economy remains unchanged.

8.44 However, if the assuming entity is in a different economy from the original debtor, then the external debt of the assuming economy (new debtor) is increased, and the external debt of the original debtor reduced by the full amount of the outstanding debt that is assumed. The terms of the debt assumption may include a legal obligation for the original debtor to pay back to the new debtor the amount of debt assumed. If so, the original debtor economy would record this new liability in the external debt position, under the relevant debt instrument(s),<sup>16</sup> and thus its gross external debt position would remain unchanged. If no claim was established, then no new liability is recorded in the external debt position of the original debtor. Every transfer of liabilities between a quasi-corporation and its owner is reflected in the value of its equity stake.<sup>17</sup>

#### Flow data

8.45 If the entity assuming the debt and the original debtor are resident in the same economy, then no balance of payments transactions are recorded. If both entities are resident in different economies, the debt-assuming economy would record the creation of the new liability to the creditor. Thereafter, the transactions in the balance of payments depend upon whether the assuming economy obtains a claim on the original debtor and, if not, the relationship between the two entities—whether the original debtor was in a direct investment relationship with the entity in the assuming economy or not. If a claim on the original debtor is established, the new debtor records an increase in a debt claim on the original debtor. If no claim is established, a capital transfer (debt forgiveness) from the assuming debtor economy to the original debtor economy is recorded,<sup>18</sup> unless the new and original debtor are in a direct investment relationship, under which circumstances an increase (or decrease) in equity is recorded.<sup>19</sup> The DRS system will record a transfer of liability as the reduction in the stock position of the original debtor and an increase in the stock position of the new debtor, if the entity assuming the debt and the original debtor are resident in the same economy. If both entities are resident in different economies, and a claim is established between the original and the new debtor, the debt assumption will be recorded in the original debtor's economy as a reduction in the stock position of the amount owed to the original creditor and an increase in the stock position of the

<sup>&</sup>lt;sup>16</sup> The debt assuming economy would record an increase in its financial assets by the same amount.

<sup>&</sup>lt;sup>17</sup> If the original debtor was in a direct investment relationship with the entity in the assuming economy, an increase in the direct investor's equity (or decrease if the parent is the original debtor) would be recorded in the direct investment enterprise.

<sup>&</sup>lt;sup>18</sup> Unless the original debtor no longer exists, in which case the original debt of the debtor to the creditor is written off in both their accounts (an other volume change is recorded in the IIP statement), and a capital transfer from the debt-assuming party to the creditor is recorded as the corresponding entry to the creation of the liability.

<sup>&</sup>lt;sup>19</sup> See *BPM6*, paragraphs 8.42-8.45 and A2.48-2.53, for a description of these transactions.

new creditor. DAC statistics include guarantees—when they are invoked—as debt assumption. $^{20}$ 

## D. Presentation of Data on Debt Reduction

8.46 In Table 8.1, as far as possible, economies should present information on debt reduction according to the sector of the debtor (public-sector-based approach), and by type of creditor. Additionally, the table captures information on debt reduction arising from debt reorganization of debt securities.

8.47 Also, data could be presented by type of debt reorganization under which the debt reduction was given: (1) debt rescheduling; (2) debt forgiveness; (3) debt conversion and debt prepayments; and (4) debt assumption. Where a debt-relief package includes elements of more than one type, separately identifying each type is encouraged. For example, if a part of the debt is to be repaid for cash, a prepayment should be recorded; if part of the debt is cancelled, debt forgiveness should be recorded; if the repayment terms of part of the debt are changed, a debt rescheduling should be recorded. But if it is not possible to provide separate identification, all debt reduction should be included along with the dominant type of reorganization in the package.

8.48 In Table 8.1, debt reduction should be recorded at the time when the external debt is reduced. If all debt reduction occurs at one time, debt reduction should be recorded at that time rather than when the debt-service payments would have fallen due. However, it is recognized that national practices may differ in this regard, and if the latter approach is followed, it should be recorded in a note to the presentation of the debt-reduction data.

8.49 Debt reorganization might also be phased over a period of time, such as under multiphase contracts, performance-related contracts, and when debt reduction is dependent on contingent events. In such circumstances, debt reduction is recorded when the change in debt-service payment schedule of the debtor takes effect-for instance, if debt reduction occurs when the debt-service payments fall due, then this is the time when the debt reduction is recorded.<sup>21</sup>

8.50 As noted above, the exchange rate used to calculate debt reduction should be the market rate on the transaction date (the midpoint between the buying and selling spot rates).

8.51 It is recommended that methodological notes accompany the presentation of debtreduction statistics. Inter alia, these notes should cover each type of debt reorganization.

8.52 In Table 8.1, debt reduction is measured only in nominal value terms. This is because the analytical usefulness of presenting debt-reduction data in market-value terms is uncertain. For instance, when an economy faces payment difficulties (which is systematically the case when the country receives debt reduction), its debt is generally valued at a deep discount, since the

<sup>&</sup>lt;sup>20</sup> In DAC statistics, the public sector in a donor country can provide guarantees to the private sector within the donor country. If the guarantee is invoked then the official sector takes over the debt and can count this as ODA (depending on debt relief provided).

<sup>&</sup>lt;sup>21</sup> In DAC statistics the debt reduction is recorded when the bilateral agreement legally comes into force.

market is still uncertain about the prospects of payment. In such circumstances, debt reorganization can result in the new debt having a higher value than the old debt. Similarly, in most cases (and in all multilateral agreements, such as those of the Paris Club or the London Club-see Box 8.2-or the HIPC Initiative), debt relief aims to restore the creditworthiness of the debtor country, thus increasing the possibility of repayment of existing debts and hence raising their market value. While there may be analytical interest in measuring the effect of debt reorganization on the value of outstanding debt—that is, the amount by which the market value rises—changes in the nominal amount outstanding rather than the market value is the preferred approach to measuring debt reduction arising from debt reorganization.

#### E. Other Transactions Related to Debt Reorganization

#### **Borrowing for Balance of Payments Support**

8.53 Borrowing for balance of payments support refers to borrowing (including bond issues) by the government or central bank (or by other sectors on behalf of the authorities) to meet balance of payments needs.<sup>22</sup> In the external debt statement, unlike the analytical presentation of the balance of payments, no special "below-the-line" recording of these borrowings or their advance repayment is required. Such borrowing is not considered debt reorganization because it does not alter the terms established for servicing an existing debt.

#### **New Money Facilities**

8.54 Some debt-reorganization packages feature new money facilities (new loan facilities that may be used for the payment of existing debt-service obligations). Nevertheless, as these new loan facilities do not alter the terms established for servicing an existing debt, these loans are not considered debt reorganization. In the gross external debt position, outstanding drawings by the debtor on new money facilities are usually recorded under long-term loans. If the existing debt liabilities remain outstanding, they should continue to be reported in the gross external debt position, until they are repaid. New money facilities are not to be recorded as debt reduction.

#### **Debt Payments on Behalf of Others**

8.55 Rather than assume the debt, a government may decide to repay a specific borrowing or make a specific payment on behalf of another institutional unit, without the guarantee being called or the debt being taken over. In this case, the debt stays recorded solely in the balance sheet of the other institutional unit, the only legal debtor. As the existing debt remains extant, and the terms remain unaltered, this is not considered debt reorganization. Such a situation may occur where the debtor is experiencing temporary financial difficulties rather than permanent financial problems.

8.56 If the transfer provided to repay the debt creates a new liability in the form of a government claim on the debtor, this is classified as external debt only if the government and other institutional unit are residents of different economies (and the debtor is not a

<sup>&</sup>lt;sup>22</sup> Borrowing for balance of payments support is described more fully in *BPM6*, paragraphs A1.14 and A1.15.

quasicorporation of the government). As with debt assumption, a capital transfer or direct investment–equity transaction is recorded if no claim is established by the paying economy. The payment of the debt service is not recorded as a payment of interest or principal by the paying economy because the payments are not related to a liability in its balance sheet.

## Defeasance

8.57 Defeasance is a technique by which a debtor exactly matches debt service outflows from a set of its liabilities with financial assets with the same debt service inflows, and removes both the asset and liabilities from its balance sheet. Although a debtor may wish to regard the defeased debt as being effectively extinguished, the *Guide* does not recognize defeasance as affecting the debt of the debtor as long as there has been no change in the legal obligations of the debtor. That is, the debt should continue to be shown on the gross external debt position of the original debtor economy is reduced, if the second unit is resident of another economy. In this case the transactions by which the assets and liabilities are moved to the second institutional unit are recorded in the balance of payments. If the two units are resident in the same economy but are classified in different sectors, while the gross external debt position remains unchanged, the sector classification of the debtor changes (a reclassification in other changes in volume account is recorded).

## **Debt write-offs**

A creditor can unilaterally decide to write-off debt owed to it, and so no longer carries it on its books. This unilateral action arises, for instance, when the creditor regards a claim as unrecoverable, perhaps because of bankruptcy of the debtor. As mentioned in paragraph 8.4, this is not debt reorganization as defined in the *Guide* because it does not involve a bilateral arrangement. The creditor records the reduction in its financial assets and the debtor records the corresponding debt liability reduction in its external debt position. No transactions are recorded, and the change in positions in both, the external debt position of the debtor economy as well as the external financial assets position of gross external debt positions at two different reference dates. A failure by a debtor economy to honor its debt obligations (default, moratorium, etc.) is also a unilateral decision that is not considered debt reorganization (see paragraph 8.4). However, in contrast to debt write-offs such failure involves no debt reduction in the external debt position of the debtor records.

# 9. CONTINGENT LIABILITIES

# A. Introduction

9.1 The financial crises of the 1990s highlighted the shortcomings of conventional accounting systems in capturing the full extent of financial exposures arising from traditional "off-balance-sheet" obligations, such as contingent liabilities, and from financial derivatives contracts. The discovery of the magnitude and role of these obligations in these crises reinforced the need to monitor them. This chapter focuses on contingent liabilities.<sup>1</sup> Guidelines for monitoring financial derivatives positions were provided earlier in the *Guide*.

9.2 Contingent liabilities have gained prominence in the analysis of public finance and the assessment of the financial position of the public sector, because while "invisible" in good times, they may result in costly fiscal surprises. An increased monitoring of contingent liabilities, which might impose substantial fiscal costs and impair fiscal sustainability, helps countries safeguard their fiscal position. Further, the increasing awareness of international markets to the relevance of contingent liabilities in assessing sovereign creditworthiness calls for more transparency.

9.3 Contingent liabilities are complex arrangements, and no single measurement approach can fit all situations; rather, comprehensive standards for measuring these liabilities and for better disclosure of information are still evolving. Indeed, experience has shown that contingent liabilities are not always fully covered in accounting systems,<sup>2</sup> although an increasing number of countries are disseminating information on contingent liabilities in their national publications.

9.4 In providing information on contingent liabilities, it is important to ensure that the information is meaningful, and understandable. To encourage the monitoring and measurement of contingent liabilities, with a view to enhancing transparency, this chapter provides some measurement approaches, after first defining contingent liabilities and then providing some reasons for their measurement. More specifically, also provided is a table for the dissemination of external debt data on an "ultimate risk" basis; that is, adjusting residence-based external debt data for certain cross-border risk transfers.

# B. Definition

9.5 Contingent liabilities are obligations that arise from a particular, discrete event(s) that may or may not occur. They can be explicit or implicit. A key aspect of such liabilities, which distinguishes them from current financial liabilities (and external debt), is that one or more conditions or events must be fulfilled before a financial transaction takes place.

9.6 Contingent liabilities are not recognized as financial assets or liabilities prior to the condition(s) being fulfilled (see *BPM6*, paragraph 5.10). An exception is made for standardized guarantees where, although each individual arrangement involves a contingent

<sup>&</sup>lt;sup>1</sup> This chapter draws on work at the World Bank and at the IMF.

<sup>&</sup>lt;sup>2</sup> See paragraphs 9.20 and 9.21, and Table 9.2 below.

liability, the number of similar guarantees is such that an actual liability is established for the proportion of guarantees likely to be called (see *2008 SNA*, paragraph 3.40).

9.7 Figure 9.1 provides an overview of the boundary between liabilities and contingent liabilities.<sup>3</sup>



9.8 A distinction is made between explicit and implicit contingent liabilities. In all macroeconomic statistical systems, explicit contingent liabilities are defined as legal or contractual financial arrangements that give rise to conditional requirements to make

<sup>&</sup>lt;sup>3</sup> The *Government Finance Statistics Manual* (IMF, 2001) recommends the treatment of liabilities for nonautonomous unfunded employer pension schemes as "liabilities" while the *SNA* allows for some flexibility (see 2008 SNA, paragraphs 17.191 - 17.199).
payments of economic value. The requirements become effective if one or more stipulated conditions arise. Implicit contingent liabilities do not arise from a legal or contractual source but are recognized after a condition or event is realized. While the focus of the chapter is largely on explicit contingent liabilities, the importance of implicit contingent liabilities is also discussed below. Table 9.1 provides a practical way of classifying the types of potential liabilities of the central government.

L <b>iabilitie</b> s	Direct	Contingent		
	(obligation in any event)	(obligation if a particular event occurs)		
Explicit Government liability as recognized by a law or contract	<ul> <li>External and domestic sovereign borrowing (loans contracted and securities issued by central government)</li> <li>Budgetary expenditures</li> <li>Budgetary expenditures legally binding in the long term (civil servants' salaries and pensions)</li> </ul>	<ul> <li>Central government guarantees for nonsovereign borrowing and obligations issued to subnational governments and public and private sector entities (development banks)</li> <li>Umbrella central government guarantees for various types of loans (mortgage loans, agriculture loans, small business loans)<sup>2</sup></li> <li>Trade and exchange rate guarantees issued by the central government</li> <li>Guarantees on borrowing by a foreign sovereign government</li> <li>Central government guarantees on private investments</li> <li>Central government insurance schemes (deposit insurance, income from private pension funds, crop insurance, flood insurance, war-risk insurance).</li> <li>Indemnities (commitments to accept the risk of loss or damage another party might suffer)</li> <li>Uncalled capital (obligation to provide additional capital on demand to an entity of which it is a shareholder, e.g. official international financial institutions)</li> </ul>		
<b>Implicit</b> Obligations that may be recognized when the cost of not assuming them could be unacceptably high	<ul> <li>Future public pensions (as opposed to civil service pensions)</li> <li>Social security schemes</li> <li>Future health care financing</li> <li>Future recurrent cost of public investments<sup>3</sup></li> </ul>	<ul> <li>Bailouts of public enterprises, financial institutions, subnational governments, and private firms that are either strategically important or "too big to fail".</li> <li>Liability cleanup in entities under privatization</li> <li>Investment failure of a nonguaranteed pension fund,</li> <li>Employment fund, or social security fund (social protection of small investors)</li> <li>Default of central bank on its obligations (foreign exchange contracts, currency defense, balance of payment stability)</li> <li>Bailouts following a reversal in private capital flows</li> <li>Environmental recovery, disaster relief, etc.</li> </ul>		

 Table 9.1. Fiscal Risk Matrix with Illustrative Examples<sup>1</sup>

Source: Adapted from Polackova Brixi (1999).

<sup>1</sup>The liabilities listed refer to the fiscal authorities, not the central bank.

 $^2$  However, guarantees issued by governments on export credits or student loans are standardized guarantees; provisions for calls under these guarantees are recognized as actual liabilities in the *Guide*, in line with the 2008 SNA and BPM6.

<sup>3</sup> Future investment recognized by a law or contract included in budgetary expenditures legally binding in the long-term.

#### **Explicit Contingent Liabilities**

9.9 Explicit contingent liabilities are those defined by the 2008 SNA as contractual financial arrangements that give rise to conditional requirements—that is, the requirements become effective if one or more stipulated conditions arise—to make payments of economic value.<sup>4</sup> In other words, explicit contingent liabilities arise from a legal or contractual arrangement. The contingent liability may arise from an existing debt—such as an institution guaranteeing payment to a third party; or arise from an obligation to provide funds—such as a line of credit, which once advanced creates a claim; or arise from a commitment to compensate another party for losses—such as exchange rate guarantees.

9.10 Explicit contingent liabilities can take a variety of forms although guarantees are the most common; however, not all guarantees are contingent liabilities (see box 9.1). Examples of explicit contingencies in a form other than guarantees include: (a) potential legal claims, which are claims stemming from pending court cases; (b) indemnities, which are commitments to accept the risk of loss or damage another party might suffer; and (c) uncalled capital, which is an obligation to provide additional capital, on demand, to an entity of which it is a shareholder (such as an international financial institution). Some of the more common explicit contingent liabilities are set out below.

#### **Box 9.1 Types of guarantees**

Three classes of guarantees are considered in the 2008 SNA and BPM6: guarantees that meet the definition of a financial derivative, standardized guarantees, and one-off guarantees.

*Guarantees that meet the definition of financial derivatives* protect, on a guarantee-by-guarantee basis, the lender against certain types of risk arising from a credit relationship by paying the guarantor a fee for a specified period. The guarantees covered are such that experience in the market allows the guarantor to apply standard master legal agreements or to make a reasonable estimate of the likelihood of the borrower defaulting and to calculate suitable terms for the financial derivative. These financial derivatives are referred to as credit derivatives, which are non-debt financial assets or liabilities—not contingent assets or liabilities. For instance, credit default swaps are included in financial derivatives as options (see *BPM6*, paragraph 5.68 and Appendix I of this *Guide*).

*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 loans will default. This default rate establishes a debt liability—not a contingent liability—, which is referred to as "provision for calls under standardized guarantee schemes" (see *BPM6*, paragraph 5.68 and Appendix I of this *Guide*).

*One-off guarantees* occur in situations in which the conditions of the loan or of the security that is guaranteed are so particular that it is not possible for the degree of risk associated with it to be calculated with any degree of precision. These guarantees are not recognized as economic assets until their activation, that is, when the event occurs that makes the guarantor responsible for the liability. These are contingent assets until activated. In most cases, a one-off guarantee is considered a contingent debt liability of the guarantor. Debt under one-off guarantees continues to be attributed to the debtor, not the guarantor, unless and until the guarantee is called. However, one-

<sup>&</sup>lt;sup>4</sup> The *European System of Accounts: ESA 1995* (Eurostat, 1996) defines contingent liabilities in a similar way.

off guarantees granted by governments to corporations in financial distress and that have a very high likelihood of being called are treated as if they were activated at inception (see *BPM6*, paragraph 5.68 and Chapter 5 of this *Guide*).

#### Loan and other payment guarantees

9.11 Loan and other payment guarantees are commitments by one party to bear the risk of nonpayment by another party - the guarantor guarantees the servicing (principal and/or interest) of the existing debt of other unit(s). Guarantors are only required to make a payment if the debtor defaults. Some of the common types of risks that are assumed by guarantors are commercial risk or financial performance risk of the borrower; market risk, particularly that arising from the possibility of adverse movements in market variables such as exchange rates and interest rates; political risk, including risk of currency inconvertibility and nontransferability of payments (also called transfer risk), expropriation, and political violence; and regulatory or policy risk, where implementation of certain laws and regulations is critical to the financial performance of the debtor.<sup>5</sup> Loan and other payment guarantees usually increase the initial debtor's access to international credit markets and/or improve the maturity structure of borrowing.

## Credit guarantees and similar contingent liabilities

9.12 Lines of credit and loan commitments provide a guarantee that undrawn funds will be available in the future, but no financial liability/asset exists until such funds are actually provided. Undrawn lines of credit and undisbursed loan commitments are contingent liabilities of the issuing institutions—namely, banks. Letters of credit are promises to make payment upon the presentation of prespecified documents.

#### Contingent "credit availability" guarantees or contingent credit facilities

9.13 Underwritten note issuance facilities (NIFs) provide a guarantee that a borrower will be able to issue short-term notes and that the underwriting institution(s) will take up any unsold portion of the notes. Only when funds are advanced by the underwriting institution(s) will an actual liability/asset be created. The unutilized portion is a contingent liability.

9.14 Other note guarantee facilities providing contingent credit or backup purchase facilities are revolving underwriting facilities (RUFs), multiple options facilities (MOFs), and global note facilities (GNFs). Bank and nonbank financial institutions provide backup purchase facilities. Again, the unutilized amounts of these facilities are contingent liabilities.

## **Implicit Contingent Liabilities**

9.15 Implicit contingent liabilities do not arise from a legal or contractual source but are recognized after a condition or event is realized. For example, ensuring systemic solvency of the banking sector might be viewed as an implicit contingent liability of the central bank or the central government.<sup>6</sup> Likewise, covering the obligations of sub-national (state and local)

<sup>&</sup>lt;sup>5</sup> Regulatory or policy-based guarantees are especially relevant in infrastructure financing. For more details and country-specific examples, see Irwin and others (1997).

<sup>&</sup>lt;sup>6</sup> The central government may intervene in the banking sector especially for recapitalization. A case in point is Indonesia, where the government's domestic debt increased from practically nothing, in the period before the crisis (mid-1997), to 500 trillion Indonesian rupiah by the end of 1999, mostly due to the

governments or the central bank in the event of default might be viewed as an implicit contingent liability of the central government. Implicit contingencies may be considered political or moral obligations that sometimes arise from expectations that government would intervene in the event of a crisis or a disaster, and may be recognized when the cost of not assuming them is believed to be unacceptably high.<sup>7</sup>

9.16 The relative importance of various types of contingent liabilities is country-specific, but implicit contingent liabilities can be costly. For instance, the fiscal cost of support for the financial system can be very high.<sup>89</sup>

9.17 Although implicit contingent liabilities are important in macroeconomic assessment, fiscal burden, and policy analysis, implicit contingent liabilities are even more difficult to measure than explicit contingent liabilities. Also, until measurement techniques are developed, there is a danger of creating moral hazard risks in disseminating information on implicit contingent liabilities of the type set out in Table 9.1. Thus, the rest of this chapter focuses only on the measurement of explicit contingent liabilities.

## C. Why Measure Contingent Liabilities?

9.18 By conferring certain rights or obligations that may be exercised in the future, contingent liabilities can have a financial and economic impact on the economic entities involved. When these liabilities relate to cross-border activity, and they are not captured in

issuance of bonds to recapitalize the banking system. The increase in the government's stock of domestic debt was accompanied by a rise in its assets, which were received in exchange for issuing bank-restructuring bonds. See also Blejer and Shumacher (2000).

<sup>7</sup> See Cebotari (2008).

<sup>8</sup> For instance, Laeven and Valencia (2010) present comprehensive data on the characteristics of systemic banking crises over the period 1970-2009, including the associated economic and fiscal costs. The cost of each crisis is estimated using three metrics: direct fiscal costs, output losses, and the increase in public sector debt relative to GDP. The economic cost of the 2007-2009 banking crises-concentrated in high income countries—was on average much larger than that of past crises, both in terms of output losses and increases in public debt. The median output loss (computed as deviations of actual output from its trend) was 25 percent of GDP in most recent crises (2007-2009), compared to a historical median of 20 percent of GDP, while the median increase in public debt (over the three year period following the start of the crisis) is 24 percent of GDP in 2007-2009 crises, compared to a historical median of 16 percent of GDP. These differences in part reflect an increase in the size of financial systems, the fact that the 2007-2009 crises were concentrated in high-income countries, and possibly differences in the size of the initial shock to the financial system. At the same time, direct fiscal costs to support the financial sector were smaller, 5 percent of GDP in 2007-2009 crises, compared to 10 percent of GDP for past crises, as a consequence of relatively swift policy action and the significant indirect support the financial system received through expansionary monetary and fiscal policy, the widespread use of guarantees on liabilities, and direct purchases of assets that helped sustain asset prices (see Laeven and Valencia, Resolution of Banking Crises: The Good, the Bad, and the Ugly, IMF WP/10/146). Natural disasters and terrorist related events have also been very costly, with economic losses sometimes reaching 200 percent of GDP (e.g., Hurricane Ivan in Grenada in 2004, see Cebotari (2008)).

<sup>9</sup> Also, a sovereign debt restructuring may impair the financial position of domestic or foreign institutions to a degree that this threatens financial stability and raises pressures for bank recapitalization and official sector bail-outs. (see "Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts", Das, Papaioannou, and Trebesch, IMF WP/12/203).

conventional accounting systems, it can be difficult to accurately assess the financial position of an economy—and the various institutional sectors within the economy—vis-à-vis nonresidents.

9.19 Analysis of the macroeconomic vulnerability of an economy to external shocks requires information on both external debt obligations and contingent liabilities. Experience has shown that contingent liabilities are not always fully covered in accounting systems. Moreover, there is an increasing realization, when assessing macroeconomic conditions, that contingent liabilities of the government and the central bank can be significant. For example, fiscal contingent claims can clearly have an impact on budget deficits and financing needs, with implications for economic policy. Recognizing the implications of contingent liabilities for policy and analysis, the *2008 SNA* (paragraph 11.24) states:

Collectively, such contingencies may be important for financial programming, policy, and analysis. Therefore, where contingent positions are important for policy and analysis, it is recommended that information be collected and presented as supplementary data. Even though no payments may eventually be due for contingent liabilities, the existence of a high level of them may indicate an undesirable level of risk on the part of those units offering them.

## D. Measuring Contingent Liabilities

## Treatment of Contingent Liabilities

9.20 Data dissemination of contingent liabilities based on contractual obligations (that is, explicit contingent liabilities) is already recommended under international statistical standards. Table 9.2 summarizes the treatment of contingent liabilities under statistical and accounting standards, in relation to their recognition as liabilities, and their data reporting requirements.

	Recognition of Contingent Liabilities as Liabilities	Data Reporting on Contingent Liabilities
Cash Accounting (IPSAS 19)	Only when the contingency is called and cash payments need to be made.	Encouraged. Under cash accounting standards no disclosure—meaning reported in notes or narratives that are regarded as an integral part of the financial statement—is currently required by IPSAS, but supplementary disclosure in line with that under accrual standards is recommended.
Accrual Accounting (IPSAS 19)	The expected cost of contractual contingent liabilities such as guarantees and legal claims, should be recognized—meaning formally recorded in the financial statements of the government as a liability— if: (i) it is more likely than not (50 percent) that the event will occur; and (ii) the amount of the obligation can be measured with sufficient reliability.	The disclosure of contractual contingent liabilities in the notes to financial statements is required as long as the possibility of the payment is not remote (that is, loss more likely than not, or loss less than likely but more than remote).

## Table 9.2. Treatment of Contingent Liabilities under Statistical and AccountingStandards: Recognition as Liabilities and Data Reporting Requirements

	Liabilities that do not satisfy these criteria should not be recognized.	
Statistical Reporting (the <i>Guide</i> )	A liability is recognized only if and when the contingency actually materializes, and is matched by a claim—that is the creditor owns a claim on the debtor.	Private sector debt owed to nonresidents and guaranteed by the public sector—through a contractual arrangement— should be presented in tables based on a public-sector based approach (Chapter 5). Debt of nonresidents, not owned by residents, guaranteed by a resident entity may be presented in table 9.3 (column 2). Data on a narrow range of contingent liabilities are presented in a memorandum table in Chapter 4. This table covers external debt of one sector guaranteed by another sector, and the cross-border provision of guarantees. In all these instances, it is recommended that the contingency be valued in terms of the maximum exposure loss (full face value).

9.21 The *Guide* does not recognize contingent liabilities within external debt, recognizing a liability only if and when the liability actually materializes, and is matched by a claim – that is the creditor owns a claim on the debtor. International Public Sector Accounting Standards—IPSAS—for the public sector, which do not require a matching creditor claim for the recognition of liability, recognize on an accrual basis contractual contingent liabilities such as guarantees and legal claims at the moment of initiation if: (a) the probability that the contingency will occur and hence a payment would have to be made is more than 50 percent; and (b) these payments can be reasonably measured.<sup>10</sup>

#### Box 9.2 Disclosing the Contingent Liabilities—Country Examples

Contingent liabilities are disclosed in an increasing number of countries, either in budget documents or other fiscal reports sent to parliament. New Zealand and Australia were pioneers in disclosing contingent liabilities, a practice that was subsequently picked up in a few other OECD countries, and in several emerging markets (Brazil, Chile, Colombia, Indonesia, Peru, and South Africa). The type of contingent liabilities disclosed varies across countries, in part reflecting their relative significance. Information on explicit loan guarantees (whether to public enterprises, financial institutions, private companies, or students) is reported by virtually all countries disclosing contingent liabilities. Disclosure of guarantees

<sup>&</sup>lt;sup>10</sup> In IPSAS contingent liabilities that meet these criteria and are recognized in financial statements are called "provisions" (defined as liabilities of uncertain timing and amount), with the remaining contingent liabilities defined as "contingent liabilities". A shortcoming of this approach is that, from an economic point of view, drawing a distinction between probable and improbable losses is not always useful; a 10 percent chance of losing \$10 million is worse than a 90 percent chance of losing \$1 million.

<sup>&</sup>lt;sup>11</sup> Increasingly, international accounting standard setters are requiring explicit contingent liabilities to be recognized at fair value. The rationale is that the contractual obligation itself is not conditional and therefore is a liability in full right. The uncertainty about future events is reflected in the valuation of the liability recognized, rather than whether it is recognized or not. This approach is consistent with the methods already used in Sweden and the U.S., where an estimate of the expected payment is made for all guarantees (see Cebotari (2008)).

related to public-private partnerships (PPP)-type arrangements, such as minimum revenue guarantees or exchange rate guarantees, is generally more limited (Chile, Colombia, Indonesia, Peru, U.K.). Other types of contingent liabilities are also reported, including those from pension guarantees (Chile, U.S.); deposit guarantees (Chile, U.S.); litigation (Australia, Brazil, Colombia, Indonesia, New Zealand, U.S.); liabilities of the central bank (Australia, Chile); and natural disasters (Indonesia).

When contingent liabilities can be quantified, their fiscal significance is reported through a variety of measures. These include: (i) the face value or the maximum loss under guarantees; (ii) the expected cost of the guarantees; or (iii) the "unexpected" costs of the guarantee, i.e. the most government can lose at, for example, a 95–99 percent confidence level (the so-called "cash flow at risk"). The latter two measures are reported either as expected annual payments over a certain time span or as the net present value (NPV) of the these payments.

Most countries do not disclose implicit contingent liabilities. It would generally be inappropriate to quantify and report implicit obligations as explicit contingent liabilities, since this would reinforce moral hazard if the private sector interprets this disclosure as a commitment or as an indication that the government is likely to provide future financial assistance. When such considerations are not at play or when the country has a clear history of taking on implicit liabilities, these are sometimes discussed in the context of contingent liability reports.

Note: See detailed information on country practices in Cebotari (2008).

#### Measuring the value of contingent liabilities

9.22 Contingent liabilities give rise to obligations that may be realized in the future, but because of their complexity and variety, establishing a single method for measuring them may not be appropriate. Several alternative ways of measuring contingencies are outlined below. The relevance of each will depend on the type of contingency being measured, and the availability of data.

9.23 A first step in accounting for contingent liabilities is for economic entities to record all such contingent liabilities as they are created, such as with an accrual-based reporting system. But how should such liabilities be valued?

9.24 The various ways in which the value of explicit contingent liabilities could be measured include: (i) the face value or maximum loss; (ii) the expected costs, which can also be viewed as the most government can lose at an about 50 percent confidence level; (iii) "unexpected" (or tail risk) costs; i.e., the most government can lose at, for example, a 95–99 percent confidence level (also called "cash flow at risk"); or (iv) the market value of the guarantee.

#### Face Value

9.25 The first approach is to record contingent liabilities at full face value or maximum potential loss. Thus, a guarantee covering the full amount of a loan outstanding would be recorded at the full nominal value of the underlying loan. The face value approach is by far the most commonly used by countries. This approach does not require quantification of probabilities that the contingent guarantee would be called. It is also a convenient measure in cases when individual contingent liabilities are disclosed, given that the provision of the estimated expected loss could either give rise to moral hazard (if the beneficiary of the guarantee infers that the guarantor is prepared to sustain a loss on the guarantee) or could damage the guarantor's case in courts or in negotiations. Hence, many countries report the

face value in the case of guarantees or insurance programs (Australia, New Zealand, U.S., and Chile) or of lawsuits (Chile, Colombia, and the U.S.).<sup>12</sup>

9.26 Only a few countries provide information on the nature and scope of unquantifiable risks (Australia, Canada, and New Zealand). These risks include various indemnities (e.g., against prosecution for public officials or unauthorized disclosure of confidential information), land claims, costs of decontaminating defense sites, potential future litigation, legal challenges against legislation, insurance against terrorist acts, and others.

9.27 For example, the New Zealand government routinely publishes the maximum potential loss to the government of quantifiable and nonquantifiable contingent liabilities,<sup>13</sup> including guarantees and indemnities, uncalled capital to international institutions, and potential settlements related to legal proceedings and disputes.

9.28 Likewise, the Australian government identifies quantifiable and nonquantifiable contingencies.<sup>14</sup> In addition, it identifies "remote" contingent losses (mostly guarantees), including nonquantifiable "remote" contingencies. The Indian government regularly reports the direct guarantees provided by the central government on external borrowings of public sector enterprises, development financial institutions, and nonfinancial private sector corporations.<sup>15</sup> The guarantees are presented by sector and at nominal value.

9.29 The maximum potential loss method has an obvious limitation: there is no information on the likelihood of the contingency occurring. Especially for loan and other payment guarantees, the maximum potential loss is likely to exceed the economic value of the contingent liability because there is no certainty that a default will occur (that is, the expected probability of default is less than unity). Theoretically, a better approach is to measure both the maximum possible loss and the expected loss, but calculating the expected loss requires estimating the likelihood of losses, which can be difficult.

## Estimating expected cost or market value

9.30 Several alternative methods of valuing the expected loss exist. These range from relatively simple techniques requiring the use of historical or market data, to quantitative models, such as complex options-pricing techniques, and simulations.

9.31 *The expected or "unexpected" costs* measures require, in addition to the face value, an assessment of the probability that the guarantees would be called. For estimating expected losses, a judgment would need to be made as to whether there was at least a 50 percent probability that a guarantee would be called. Some countries disclose the expected losses under various probabilities and types of guarantees (Chile, Colombia, and Peru) and some disclose also "unexpected" losses (Chile at a 95 percent confidence level, Colombia at a 99

<sup>&</sup>lt;sup>12</sup> See Table 5 in Cebotari (2008) for detailed country practices.

<sup>&</sup>lt;sup>13</sup> New Zealand Treasury, Budget Economic and Fiscal Update (Wellington, annual). As the name suggests, nonquantifiable contingent liabilities cannot be measured and arise from either institutional guarantees that have been provided through legislation or from agreements and arrangements with organizations.

<sup>&</sup>lt;sup>14</sup> Aggregate Financial Statement (Australia, annual).

<sup>&</sup>lt;sup>15</sup> See the Ministry of Finance's annual publication on external debt, India's External Debt: A Status Report.

percent level).<sup>16</sup> Another way to deal with the difficulty of quantifying probabilities for a variety of possible outcomes, is to provide a *range of estimated losses*, as done by the U.S. in the case of some lawsuits, for example.

9.32 Simulation models can be used as a method for estimating the expected or unexpected cost measures. For instance, these models estimate the probability distribution of losses from a guarantee by simulating, rather than assuming, the evolution of relevant risk factors underlying the guarantee. This distribution is then used to price the guarantees (estimate the expected loss) and also allows estimation of the maximum losses that may occur at a given confidence level (for example, the maximum payments at a 95 percent confidence level means that the probability of higher payments—than these maximum ones— being called is 5 percent). These models are employed for valuing guarantees associated with demand behavior such as infrastructure guarantees (for example, road concessions with revenue guarantees).

9.33 Calculating probabilities requires detailed market information, but such information is often unavailable. This is particularly true in situations of market failure or incomplete markets—a financial marketplace is said to be complete when a market exists with an equilibrium price for every asset in every possible state of the world. Other means are then required to estimate the probability to value a contingency. One possibility is to use historical data on similar types of contingent operations. For example, if the market price of a loan is not observable, but historical data on a large number of loan guarantees and defaults associated with those guarantees are available, then the probability distribution of the default occurrences can be used to estimate the expected cost of a guarantee on the loan. This procedure is similar to that employed by the insurance industry to calculate insurance premiums. Rating information on like entities is often used to impute default value on loan guarantees as well. The U.S. Export-Import Bank employs this method for valuing loan guarantees that it extends.

9.34 Bank regulatory guidelines established by the Basel Committee on Banking Supervision also draw on historical data to measure risks in banks' off-balance-sheet activities and could be used in the absence of good market information for calculating probabilities. For traditional off-balance-sheet items like credit contingent liabilities, the socalled Basel II guidelines provide "credit conversion factors," which when multiplied with the notional principal amount provide an estimate of the expected "payout" from the contingent liability. The conversion factors are derived from the estimated size and likely occurrence of the credit exposure, as well as the relative degree of credit risk. Thus, stand-by letters of credit have a 100 percent conversion factor; the unused portion of commitments with an original maturity of over one year is 50 percent; and RUFs, NIFs, and similar arrangements are assigned a 50 percent conversion factor as well.

<sup>&</sup>lt;sup>16</sup> The expected loss is the average loss, that is, the mean of a loss distribution. The unexpected loss is the difference between the total exposure at the target risk tolerance level and the expected loss; for instance total exposure at the 99% confidence level represents the level of loss where a larger loss has a one percent chance of occurring. In the banking industry expected losses are referred to as the "normal" losses that occur frequently as part of everyday business, whereas unexpected losses are the "unusual" losses that occur rarely and have a high severity.

9.35 If the expected loss can be calculated, the loss(es) can be valued in present-value terms—expected present value. In other words, since any payment will be in the future and not immediate, the expected future payment streams could be discounted using a market rate of interest faced by the guarantor; that is, the present value. As with all present-value calculations, the appropriate interest rate to use is crucial; a common practice with government contingent liabilities is to use a risk-free rate like the treasury rate. Under this present-value approach, when a guarantee is issued the present value of the expected cost of the guarantee could be recorded as an outlay or expense (in the operating account) in the current year and included in the position data, such as a balance sheet.

9.36 *Market-value* measures use market information to value a contingency. This methodology can be applied across a wide range of contingent liabilities, but it is particularly useful for valuing loan and other payment guarantees, on which the following discussion focuses. This methodology assumes that comparable instruments with and without guarantees are observable in the market and that the market has fully assessed the risk covered by the guarantee. Under this method, the value of a guarantee on a financial instrument is derived as the difference between the price of the instrument without a guarantee and the price inclusive of the guarantee. In the context of a loan guarantee, the nominal value of the guarantee would be the difference between the contractual interest rate (*ip*) on the unguaranteed loan and the contractual interest rate (*ig*) on the guarantee would use market, not contractual, rates.<sup>17</sup>

9.37 Yet another approach to valuing contingent liabilities applies *option-pricing techniques* from finance theory.<sup>18</sup> With this method, a guarantee can be viewed as an option: a loan guarantee is essentially a put option written on the underlying assets backing the loan.<sup>19</sup> In a loan guarantee, the guarantor sells a put option to a lender. The lender, who is the purchaser of the put option, has the right to "put" (sell) the loan to the guarantor. For example, consider a guarantee on a loan with a nominal value of *F* and an underlying value of *V*. If *V* - *F* < 0, then the put option is exercised and the lender receives the exercise price of *F*.<sup>20</sup> The value of the put option at exercise is *F* - *V*. When *V* > *F*, the option is not exercised. The value of the guarantee is equivalent to the value of the put option. If the value of the credit instrument on which a guarantee is issued is below the value at which it can be sold to the guarantor, then the guarantee will be called.

9.38 Although the option-pricing approach is relatively sophisticated, it is being applied in the pricing of guarantees on infrastructure financing and interest and principal payment guarantees.<sup>21</sup> But standard option pricing has its limitations as well. This is because the

 $^{20}$  In options, the exercise price (or strike price) is the fixed price at which the owner of an option can purchase (in the case of a call), or sell (in the case of a put), the underlying item.

<sup>&</sup>lt;sup>17</sup> For a further discussion of market-value methods see Towe (1990) and Mody and Patro (1996).

<sup>&</sup>lt;sup>18</sup> An option agreement is a contract giving the holder the right, but not the obligation, to buy (i.e., call) or sell (i.e., put) a specified underlying asset at a pre-agreed price (the exercise or strike price), either at a fixed point in time (*the European option*) or at a time chosen by the holder until maturity (*the American option*).

<sup>&</sup>lt;sup>19</sup> Robert C. Merton (1977) was the first to show this.

<sup>&</sup>lt;sup>21</sup> See Irwin and others (1997) and Borensztein and Pennacchi (1990).

standard option-pricing model assumes an exogenous stochastic process for underlying asset prices. However, it can be argued that the very presence of a guarantee (especially a government guarantee) can affect asset prices.<sup>22</sup>

#### **Recommended Measures**

9.39 The *Guide* encourages the measurement and monitoring of contingent liabilities, especially of guarantees, and has outlined some measurement techniques. However, it is recognized that comprehensive standards for measuring contingent liabilities are still evolving. Consequently, only the recording of a narrow, albeit important, range of contingent liabilities is specified ahead: the value of guarantees of residents' external debt liabilities (including guarantees of domestic private sector external debt by the public sector), and the cross-border provision of guarantees. In both instances, it is recommended that the contingency should be valued in terms of the maximum exposure loss (full face value).

## Guarantees of residents' external debt liabilities

9.40 In Chapter 4, Table 4.7 summarizes the value of guarantees of residents' external debt liabilities by sector of the guarantor—liabilities of a unit of a resident sector, the servicing of which is contractually guaranteed by a unit of another sector resident in the same economy of the debtor)<sup>23</sup>—and cross-border guarantees (see Table 9.2).<sup>24</sup>

9.41 In Chapter 5, the dissemination of data on publicly guaranteed private sector debt that is, the value of private sector debt that is owed to nonresidents and is guaranteed by the public sector—through a contractual arrangement is discussed.

## Ultimate risk

9.42 Set out in Table 9.3 is a format that presents external debt according to an "ultimate" risk concept—augmenting residence-based data to take account of the extent to which external debt is guaranteed by residents for nonresidents. Countries could potentially have debt liabilities to nonresidents in excess of those recorded as external debt on a residence basis if their residents provide guarantees to nonresidents that might be called. Also, branches of domestic institutions located abroad could create a drain on the domestic economy if they ran into difficulties and their own head offices needed to provide funds. Indeed the latter circumstances arose for some economies during the global crisis of the 2008-2009.

9.43 In Table 9.2 residence-based external debt data (column 1) is increased by the amount of debt of nonresidents, not owned by residents, that is guaranteed by a resident entity (inward risk transfer, column 2). Column 3 is the adjusted external debt exposure of the economy. The table is set out in this manner so that external debt on an ultimate-risk basis can be related back to the gross external debt position measured on a residence basis.

<sup>&</sup>lt;sup>22</sup> See Sundaresan (2002) for a detailed exposition on this issue.

<sup>&</sup>lt;sup>23</sup> These liabilities are covered in the gross external debt position as debt of the sector of the original debtor, whereas in Table 4.7 they are presented as contingent liabilities (guarantees) of the sector of the guarantor.

<sup>&</sup>lt;sup>24</sup> Cross-border guarantees are included in Table 9.3, column 2, as inward risk transfer.

9.44 The intention of column 2 is to measure any additional external debt risk exposures of residents arising from contingent liabilities. The definition of contingent liabilities adopted is deliberately narrow. To be included in this definition of contingent liabilities, the debt must exist, so lines of credit and similar potential obligations are not included. The data on the inward transfer of risk covers only the debt of a nonresident to a nonresident on which, and as part of the agreement between debtor and creditor, payments are guaranteed to the creditor(s) by a resident entity under a legally binding contract—the guarantor will most commonly be an entity that is related to the debtor (for example, the parent of the debtor entity), and debt of a legally dependent nonresident branch of a resident entity that is owed to a nonresident. If debt is partially guaranteed, such as if principal payments or interest payments alone are guaranteed, then only the present value of the amount guaranteed should be included in columns 2 or 4. To avoid double counting the same external debt risk exposure, the following should be excluded from column 2: all debt liabilities of nonresident branches to other nonresident branches of the same parent entity; and any amounts arising from external debt borrowings of nonresidents that were guaranteed by a resident entity and on-lent by the nonresident borrower to that same resident entity or any of its branches. This guidance is not intended to exclude debt exposures of residents from the ultimate risk concept, as defined above, but to ensure that they are counted only once.

9.45 External debt is the liability of the debtor economy. However, as a memorandum item, the amount of external debt of the economy that is guaranteed by nonresidents is also presented (outward risk transfer, column 4). The data on the transfer of risk outward covers only external debt on which, and as part of the agreement between debtor and creditor, payments are guaranteed (or partially guaranteed) to the creditor(s) by a nonresident under a legally binding contract—the guarantor will most commonly be an entity that is related to the debtor (for example, the parent of the debtor entity) —and external debt of a resident entity that is a legally dependent branch of a nonresident entity.

9.46 No reallocation of risk is made because of the provision of collateral by the debtor, or because a debt instrument is "backed" by a pool of instruments or streams of revenue originating from outside of the economy. Because the intention of Table 9.2 is to monitor the potential risk transfer from the debtor side, no reallocation of risk is made if the risk transfer is initiated from the creditor side, without any involvement of the debtor—for example, the creditor has paid a premium to a guarantor, such as an export credit agency unrelated to the debtor, to insure against payment default or has purchased a credit derivative that transfers credit risk exposure.

Table 9.3. Gross External Debt Position: Ultimate Risk Basis					
		End-Period			
	Gross External Debt (1)	Inward risk transfer (+) (2)	External Debt (ultimate-risk basis) (3)	Memorandum item: Outward risk transfer (4)	
General Government					
Short-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/3/					
Long-term					
Special drawing rights (SDRs), Allocation					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/					
Central Bank					
Short-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/3/					
Long-term					
Special drawing rights (SDRs) Allocation					
Currency and denosits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/					
Deposit-Taking Corporations, except the Central Bank					
Short-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/3/					
Long-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/					
Other Sectors					
Short-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/3/					
Long-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/					
other debt habilities 2/					

#### External Debt Statistics: Guide for Compilers and Users

Table 9.3. Gross External Debt Position: Ultimate Risk Basis (Continued)					
		End-Period			
	Gross External Debt	Inward risk transfer (+)	External Debt (ultimate-risk basis)	Memorandum item: Outward risk transfer	
	(1)	(2)	(3)	(4)	
Other financial corporations					
Short-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/ 3/					
Long-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/					
Nonfinancial corporations					
Short-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/ 3/					
Long-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/					
Households and nonprofit institutions serving households (NPISHs)					
Short-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/3/					
Long-term					
Currency and deposits 1/					
Debt securities					
Loans					
Trade credit and advances					
Other debt liabilities 2/					
Direct Investment: Intercompany Lending	1	ĺ	1	1	
Debt liabilities of direct investment enterprises to direct investors					
Debt liabilities of direct investors to direct investment enterprises					
Debt liabilities between fellow enterprises					
Gross External Debt Position	1		1	-	
1/ It is recommended that all currency and denosits he included in the shor	-term category up	less detailed info	rmation is availab	hle to make the	
short-term/long-term attribution.	. ter in category un			one to make the	
				D -+-++	

 2/ Other debt liabilities comprise insurance, pension, and standardized guarantee schemes, and other accounts payable in the IIP statement.

 3/ Arrears are recorded in the original debt instrument rather than in other debt liabilities, short term.

## **Appendix I. 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 I. Financial Instruments: Description and Classification in the Gross External Debt Position<sup>158</sup>

## 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—that is, 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 4.4) under the appropriate institutional sector. If the nonresident is in a direct investment fund shares (Table 4.5).

<sup>&</sup>lt;sup>158</sup> This appendix has drawn significantly upon the Bank of England (1998), *Financial Terminology Database, and BPM6 Chapter 5.* 

#### Arrears

Amounts that are past due-for-payment and unpaid. These include amounts of scheduled debtservice 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 III.

Arrears also include amounts related to other nondebt-instruments and transactions such as, a financial 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 nondebt transactions are debt liabilities that should be recorded as *other debt liabilities* in the gross external debt position (*other investment, 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—for example, 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 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 invest-ment*, *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.

## С

## **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 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).

## **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 allows 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 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.

#### **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* 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; and
- *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 counter-party 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).

## **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; that is, 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; for example, 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. Creditlinked 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. 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 (that is, 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 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 fund 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—for example, savings and fixed-term deposits; sight deposits 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, for example, 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, except the central bank, *short-term, currency and deposits (other investment* in the IIP).

#### **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).

#### Е

#### **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**

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 investment.* 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; and

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

## **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).

#### Fixed-Spread Loan (FSL, World Bank)

FSLs are committed and repayable in the currency or currencies of the loan selected by the borrower. IBRD offers FSLs in euro, Japanese yen, U.S. dollars, and other currencies that it can efficiently intermediate. Borrowers may decide to contract FSLs in more than one currency tranche. For all FSLs, there is an absolute final maturity of 25 years. Borrowers may choose between two amortization schedules for FSLs: a commitment-linked schedule or a disbursement-linked schedule. In both types of schedules, repayment installments are calculated as a portion of the disbursed and outstanding amount of the loan. Under the first type of schedule, the timing of principal repayments is linked to the time of loan commitment. Under the second option, the schedule has a level pattern of repayment, and the timing of principal repayments depends on the timing of actual disbursements (the grace period is applied to each actual disbursement which translates to a multi-tranche loan facility with each tranche having its own repayment terms).

#### Classification

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

## **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; and
- 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 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 II; 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 classified 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 (for

example, 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 should be added to the value of the underlying instrument (see *BPM6*, paragraphs 11.61-11.65 for treatment of interest when the amount to be paid at maturity is index-linked).

#### Insurance, pension, and standardized guarantee schemes

Insurance, pension, and standardized guarantee schemes is a type of debt instrument that comprises (a) nonlife insurance technical reserves; (b) life insurance and annuity entitlements; (c) pension entitlements, claims of pension funds on pension managers, and entitlements to nonpension funds; and (d) 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); and
- 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 counter-party is a nonresident are included indistinguishably in the memorandum table, *financial derivatives and employee stock options positions with nonresidents by sector (Table 4.3)*.

#### 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. There 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—that is, 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 and/or leases these assets for long periods, then a notional resident entity is created on which the nonresident has a financial claim.

#### 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.

#### 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).

## $\mathbf{M}$

## 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 margin consist of cash or other collateral deposited to protect the counterparty

against default risk. Ownership of the margin remains with the unit that deposited it. Repayable margins in cash are a debt liability. Nonrepayable 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* (if the debtor's liabilities are included in broad money) or in *short-term, other debt liabilities* (*other investment, currency and deposits or 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 Non-Pooled
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—non-pooled— 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 non-pooled— 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.

## Ν

## 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

Nonlife 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

Nonlife 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 invest*-

ment, intercompany lending (see the description of direct investment in Chapter 3).

## **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

Nonparticipating 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).

## Nonnegotiable Debt

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

## Classification

Depends on the nature of the instrument.

## 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).

## 0

## **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*).

#### **Other Accounts Receivable/Payable-Other**

*Other accounts receivable/payable-other* include nondebt related arrears (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).

## Р

## **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 4.4) 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 a 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 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). Investor demand for perpetual floating-rate notes has been weak in recent years.

## 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).

## **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).

#### **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 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).

## R

## **Reverse Security Transactions**

See Appendix II.

## S

## **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 monetary authorities of IMF members and a limited number of international financial institutions that are authorized holders. SDR holdings (assets) represent unconditional rights to obtain foreign exchange or other reserve assets from other IMF members. SDR allocations are recorded as the incurrence of a long-term debt liability of the member receiving them (because of a requirement to repay the allocation in certain circumstances, 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*, *allocation (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 (that is, a longdated 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.

## 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*).

## Т

## **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 (a) credit extended directly by the suppliers of goods and services to their customers and (b) 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). 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). Nonconcessional 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 <a href="http://www.imf.org/external/np/exr/facts/howlend.htm">http://www.imf.org/external/np/exr/facts/howlend.htm</a>.

## 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 (for example, 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 invest-ment, 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; and
- 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. Classification of Specific Transactions

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

#### **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. For example, a government may use a 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.

#### **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—that is, 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 (for example, 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" (for example, 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—that is, goods intended for sale but not actually sold at the time of crossing a frontier—because ownership of the goods has not changed hands.

#### 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, ownership of the liabilities remains unchanged, and should be reported as external debt of the original debtor. Defeasance may be carried out (a) by placing the paired assets and liabilities in a separate account within the institutional unit concerned or (b) 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. 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.

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 monetary gold, SDRs, currency, 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 case are: (a) deposit-taking corporations (both central banks and deposit-taking corporations other than the central bank); (b) investment funds; and (c) other financial intermediaries except insurance corporations and pension funds (see *BPM6*, paragraph 6.28).

## 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 have 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 financial intermediation service charges indirectly measured (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. 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 intermediaries. 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. 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.

## **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 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—for example, the lessee is responsible for repairs and maintenance, and the lessor is a financial institution, etc.

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.

## **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.

## Islamic Banking<sup>159</sup>

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

<sup>&</sup>lt;sup>159</sup> Islamic banking is described in detail in Appendix 2 of the IMF's *Monetary and Financial Statistics Manual* (IMF, 2000d), and in Annex 2 of the Handbook of Security Statistics, Part I (BIS, ECB, and IMF, 2009).

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. 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 permanent capital of an institutional unit. 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.

## 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—for example, in the event of a major financial crisis—it can activate these arrangements.

The GAB is a long-standing credit arrangements 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

http://www.imf.org/external/np/exr/facts/gabnab.htm.

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.

#### **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 occur. 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, Appendix I, Part I.

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; for example 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.

## **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.

## **On-Lending of Borrowed Funds**

An institutional unit within an economy might borrow funds from a nonresident(s) and then onlend the funds to a second institutional unit within the economy. In such instances, the first institutional unit—that is, 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 held in another economy. 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 after the funds are moved from the first to the second economy at the end of the day and not after they are returned to the first economy. 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.

## **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) (that is, 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 debt, 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 occurs 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; and
- 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 Investment Projects**

Public investment projects involve the construction and operation by private corporations of assets of a kind that are usually the responsibility of the general government sector, or public corporations. These commonly include, for example, 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). But if the private sector corporation is a nonresident, the classification of the transactions as external debt depends on the nature of the arrangement:

• Where an asset is constructed by a corporation and transferred to government on completion, any prepayments by the government are claims on a nonresident enterprise—that is, external debt of the private nonresident corporation. If the government only pays 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 corporation, these are classified in the normal way as operating or finance leases, and hence external debt or not, depending on whether the government or 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 own the asset but will transfer ownership to the government at a later date, and in the meantime the government makes payments both to cover the costs of operating the asset and to meet the financing costs, then a finance lease, and hence external debt, arises for the government and should be recorded as such.

As with all finance 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—Appendix to Chapter 2, examples 1 and 2, provides calculations that illustrate the principles involved.

## 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 (for example, 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 provider'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 (a) the "reserve tranche," that is, the foreign currency (including SDRs) amounts that a member country may draw from the IMF at short notice; and (b) 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).

## **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 a SWF controlled by government in the general government or financial corporations sectors is determined according to the criteria set out in *BPM6*, paragraphs 4.63–4.92; that is, government-controlled enterprises that (a) produce market output (i.e., charge prices that are economically significant), and (b) 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.

# 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—for example, because of extra charges arising from rescheduling—the gross external debt position increases.

## Trading of Nonnegotiable 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 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 (see *BPM6*, paragraph 9.33).

## **Appendix III. Glossary of External Debt Terms**

## A

#### **Accrual of Interest Costs**

Continuous recording of interest costs, so matching the cost of capital with the provision of capital.

#### Affiliates

Enterprises related through direct investment relationships. Consist of the *direct investors* (*s*), both immediate and indirect; the *direct investment enterprises*, whether subsidiaries (including branches and other quasicorporations), associates, and subsidiaries of associates, both immediate and indirect; and *fellow enterprises*, that is, those enterprises that are under the control or influence of the same immediate or indirect investor, but neither fellow enterprises controls or influences the other fellow enterprises. Affiliates are also known as "affiliated enterprises" because they are almost always enterprises.

#### **Agreed Minute**

*Paris Club* document detailing the terms for a *debt rescheduling* between *creditors* and the *debtor*. It specifies the coverage of *debt-service* payments (types of debt treated), the *cutoff date*, the *consolidation period*, the proportion of payments to be rescheduled, the provisions regarding the down payment (if any), and the repayment schedules for rescheduled and deferred debt. Creditor governments commit to incorporate these terms in the bilateral agreements negotiated with the debtor government that implements the *Agreed Minute*. Paris Club creditors will agree to reschedule only with countries that have an IMF upper credit *tranche* arrangement (*Stand-By Arrangement* or *Extended Fund Facility* (EFF)), a *Poverty Reduction and Growth Facility* (PRGF) arrangement, or a *Rights Accumulation Program*.

#### **Amortized Value**

Amortized value of a loan reflects the decline in the value of the liability by regular payments over a specified period of time. At the time of each scheduled payment, amortized value is the same as *nominal value*, but it may differ from the nominal value in other dates because nominal value includes accrued interest costs that have not been paid.

#### **Amortization Schedule**

The schedule for the repayment of *principal* and payment of *interest* on an ongoing basis. For loans, the amortization schedule is normally included in an annex to the contract or can be estimated from the contract.

#### Arbitrage

Buying (or borrowing) in one market and selling (or lending) in the same or another market to profit from market inefficiencies or price differences.

## Arrangement on Guidelines for Officially Supported Export Credits

The Arrangement is a gentleman's agreement governing the provision of officially supported *export credits* with a credit period of two years or more. It is negotiated by an international body called the Participants to the *Arrangement on Guidelines for Officially Supported Export Credits*, which meets in Paris under the auspices, and with the administrative support, of the Secretariat of the OECD. The Participants are Australia, Canada, the European Union (including all the Member States), Japan, Korea, New Zealand, Norway, Switzerland, and the United States.

## B

## **Balance of Payments**

A statistical statement that systematically summarizes, for a specific period of time, transactions between residents and nonresidents. It consists of the goods and services accounts, the primary and secondary income accounts; the capital account; and the financial account.

#### **Bank for International Settlements (BIS)**

Established in 1930 by intergovernmental convention, the BIS promotes discussion and facilitates cooperation among central banks. In this capacity, the BIS carries out four main activities: (a) it organizes meetings for central banks and supervisory agencies; (b) it supports economic, monetary, financial, and legal research and it is a hub for sharing statistical information amongst central banks, and publishing statistics on global banking, securities, foreign exchange and derivatives markets; (c) it organizes seminars and workshops; and (d) it offers a wide range of financial services to assist central banks and other official monetary institutions in the management of their foreign reserves.

#### **Berne Union**

The International Union of Credit and Investment Insurers (Berne Union). This Union is an informal association of *export credit insurance agencies and/or investment insurance companies and agencies*, founded in 1934. The two main objectives of the *Berne Union* are the promotion of the international acceptance of sound principles in export credit insurance and investment insurance, and the exchange of information relating thereto. The almost 50 members meet several times per year at general or specialist meetings to exchange information and discuss matters of common interest. They also consult with each other on a continuing basis, and cooperate closely. All members participate as insurers and not as representatives of their governments.

## **Bilateral Deadline**

In the context of Paris Club *reschedulings*, the date by which all bilateral agreements must be concluded. It is set in the *Agreed Minute* and is typically about six months later, but can be extended upon request.

## **Bilateral Debt**

Loans extended by a bilateral *creditor*.

#### **Bilateral Rescheduling Agreements**

*Rescheduling agreements* reached bilaterally between the *debtor* and *creditor* economies. These are legally the equivalent of new loan agreements. After a Paris Club *rescheduling*, such agreements are required to put into effect the *debt restructuring* set forth in the multinational *Agreed Minute*.

#### **Bullet Repayment**

The repayment of *principal* in a single payment at the maturity of the debt.

## **Buyer's Credit**

A financial arrangement in which a bank or financial institution, or an *export credit agency* in the exporting economy, extends a loan directly to a foreign buyer or to a bank in the importing economy to pay for the purchase of goods and services from the exporting economy. Also known as financial credit. This term does not refer to credit extended directly from the buyer to the seller (for example, through trade credit and advances payment for goods and services).

#### С

## **Capital Account**

In the international accounts, the *capital account* shows (a) *capital transfers* receivable and payable between residents and nonresidents and (b) the acquisition and disposal of nonproduced, nonfinancial assets between residents and nonresidents.

## **Capital Transfers**

Consists of transfers in which the ownership of an asset (other than cash and inventories) changes from one party to another; or which obliges one or both parties to acquire or dispose of an asset (other than cash or inventories); or where a liability is forgiven, by the *creditor*.

#### **Capitalized Interest**

*Capitalized interest* is the conversion of accrued *interest* costs or future interest payments, by a contractual arrangement with the creditor, into a new *debt instrument* or *principal of the current debt instrument*. The most common form of capitalization is the reinvestment of

interest costs into the principal amount, either because of an explicit agreement regarding the specific debt instrument or as part of a *rescheduling agreement*. Frequently as part of a rescheduling agreement, some percentage of interest due during the *consolidation period* (see below) is converted, through an agreement made with the *creditor*, into principal.

## **Claim Payments**

Payments made to exporters or banks after the *claims-waiting period* by an *export credit agency* on insured or guaranteed loans when the original borrower or borrowing-economy guarantor fails to pay. Claim payments are recorded by the agencies as unrecovered claims until they are recovered from the *debtor* or the debtor's guarantor.

#### **Claims-Waiting Period**

The period that exporters or banks must wait after the due-date of payment before the *export credit agency* will pay on the corresponding claim.

## Cofinancing

The joint or parallel financing of programs or projects through loans or grants to developing economies provided by commercial banks, *export credit agencies*, other official institutions in association with other agencies or banks, or the World Bank and other multilateral financial institutions (See also *Multilateral Creditors*).

#### **Commercial Credit**

In the context of the Paris Club, loans originally extended on terms that do not qualify as *official development assistance* (ODA) credits. These are typically *export credits* on market terms but also include other non-ODA loans by governments.

#### **Commercial Interest Reference Rates (CIRRs)**

A set of currency-specific interest rates for OECD countries. CIRRs have been established on the basis of secondary market yields on government bonds. These data are published monthly on the Internet at: <u>http://www.oecd.org/trade/xcred/arrangement/rates/</u>. CIRRs are adjusted monthly and are intended to reflect commercial rates.

#### **Commercial Risk**

In the context of *export credits*, the risk of nonpayment by a nonsovereign or private sector buyer or borrower in his or her domestic currency arising from default, insolvency, and/or a failure to take up goods that have been shipped according to the supply contract (contrasted with *transfer risk* arising from an inability to convert domestic currency into the currency in which the *debt service* is payable, or with broader *political risk*).

#### Commitment

Generally, a firm obligation to lend, guarantee, or insure resources of a specific amount

under specific financial terms and conditions. However, in the OECD's *Arrangement on Guidelines for Officially Supported Export Credits*, commitment simply refers to any statement, in whatever form, whereby the willingness or intention to provide official support is communicated to the recipient economy, the buyer, the borrower, the exporter, or the financial institution.

#### **Commitment Charge (or Fee)**

This is the charge made for holding available the *undisbursed* balance of a loan commitment. Typically, it is a fixed-rate charge (for example, 1.5 percent a year) calculated on the basis of the undisbursed balance.

#### **Commitment**, **Date** of

The date on which the *commitment* is made.

## **Comparable Treatment**

An understanding in a *debt-restructuring* agreement with the Paris Club *creditors* that the *debtor* will secure at least equivalent *debt relief* from other creditors.

## **Complete Market**

A financial market place is said to be complete when a market exists with an equilibrium price for every asset in every possible state of the world.

## **Completion Point**

In the context of the *HIPC Initiative* (see below), when the IMF and World Bank Executive Boards decide that an economy has met the conditions for assistance under the Initiative. The timing of the completion point depends on the satisfactory implementation of key structural policy reforms agreed at the *decision point*, the maintenance of macroeconomic stability, and the adoption and implementation of a poverty reduction strategy developed through a broad-based participatory process. (See also *Decision Point*.)

#### **Concessional Loans**

These are loans that are extended on terms substantially more generous than market loans. The concessionality is achieved either through interest rates below those available on the market or by *grace periods*, or a combination of these. *Concessional loans* typically have long grace periods.

#### **Concessional Restructuring**

*Debt restructuring* with a reduction in *present value* of the *debt service*. In the context of the Paris Club, *concessional restructuring* terms have been granted to *low-income countries* since October 1988 with a reduction in the present value of *eligible debt* of up to one-third (Toronto terms); since December 1991, with a present value reduction of up to one-half

(London terms or "enhanced concessions" or "enhanced Toronto" terms); and, since January 1995, with a present value reduction of up to two-thirds (Naples terms). In the context of the *HIPC Initiative, creditors* agreed in November 1996 to increase the present value reduction to up to 80 percent (Lyon terms) and then in June 1999 to 90 percent (Cologne terms). Such restructuring can be in the form of *flow restructuring* or *stock-of-debt operations*. While the terms (*grace period and maturity*) are standard, creditors can choose from a menu of options to implement the *debt relief*.

## **Concessionality Level**

A *net present value* calculation, measured at the time the loan is extended, that compares the outstanding *nominal value* of a debt and the future *debt-service* payments discounted at an *interest* rate applicable to the currency of the transaction, expressed as a percentage of the nominal value of the debt. The concessionality level of *bilateral debt* (or tied aid) is calculated in a similar manner, but instead of using the nominal value of the debt, the *face value* of the loan is used—that is, including both the *disbursed* and *undisbursed* amounts, and the difference is called the *grant element*. (See also *Grant Element* and *Net Present Value*.)

## **Consolidated Amount or Consolidated Debt**

The *debt-service payments* and arrears, or debt stock, restructured under a Paris Club *rescheduling agreement*.

## **Consolidated Banking Statistics (BIS)**

The BIS consolidated banking statistics report banks' on-balance sheet financial claims on the rest of the world on an immediate borrower basis, and, after risk transfers, on an ultimate risk basis. They thereby provide a measure of the risk exposures of lenders' national banking systems. The quarterly data cover contractual lending by the head office and all its branches and subsidiaries on a worldwide consolidated basis, that is, net of inter-office accounts. In addition to on-balance sheet financial claims, derivative contracts, guarantees and credit commitments are also reported.

## **Consolidated Reporting**

Reporting covering the claims and liabilities of all offices worldwide of the same entity, but excluding positions between offices of the same entity. Offices include head offices, branch offices, and subsidiaries. A consolidated balance sheet refers to a balance sheet grouping of assets and liabilities of a parent company and all its offices, after elimination of all unrealized profits on intragroup trading and of all intragroup balances.

## **Consolidation Period**

In Paris Club restructuring agreements, the period in which *debt service* to be restructured (the "current maturities consolidated") have fallen or will fall due. The beginning of the *consolidation period* may precede, coincide with, or come after the date of the *Agreed Minute*. The standard consolidation period is one year, but sometimes debt payments over a

two- or three-year period have been consolidated, corresponding with a multiyear arrangement with the IMF.

## **Contingent Asset/Liability (Contingencies)**

Contingent assets and liabilities are contractual financial arrangements between institutional units that do not give rise to unconditional requirements either to make payments or to provide other objects of value. They are not recognized as financial assets or liabilities prior to the condition(s) being fulfilled. Lines of credit, letters of credit, and loan commitments assure that funds will be made available, but no financial asset (i.e., loan) is created until funds are actually advanced.

## Cover

Provision of *export credit* guarantee or insurance against risks of payment delays or nonpayments relating to export transactions. Cover is usually, though not always, provided for both *commercial risk* and *political risk*. In most cases, cover is not provided for the full value of future *debt-service* payments; the percentage of cover is typically between 90 percent and 95 percent. (See also *Quantitative Limits.*)

## **Coverage of Rescheduling Agreements**

The *debt service* or arrears rescheduled. Comprehensive coverage implies the inclusion of most or all *eligible debt service* and arrears.

## Credit

An amount for which there is a specific obligation of repayment. Credits include loans, trade credits, bonds, bills, etc., and other agreements that give rise to specific obligations to repay over a period of time usually, but not always, with *interest*. *Credit* is extended to finance consumption and investment expenditures, and financial transactions.

## **Credit Guarantee**

Commitment by an *export credit agency* to reimburse a lender if the borrower fails to repay a loan. The lender pays a guarantee fee.

## **Credit Insurance**

The main business of most *export credit agencies* is insurance of finance provided by exporters or banks (although some major agencies lend on their own account). Insurance policies provide for the export credit agency to reimburse the lender for losses up to a certain percentage of the *credit* covered and under certain conditions. Lenders or exporters pay a premium to the export credit agency. Insurance policies typically protect the lender against political or *transfer risks* in the borrowing economy that prevent the remittance of *debt-service* payments.

## Creditor

An entity with a *financial claim* on another entity.

#### **Creditor Economy**

The economy in which the creditor resides. In Paris Club terminology, it is an official bilateral creditor.

## **Creditor Reporting System**

A statistical reporting system maintained by the OECD on aid activities. It contains detailed quantitative and descriptive data on individual aid projects and programs. CRS data are used to analyze the sectoral and geographical breakdown of aid for selected years and donors, to examine aid that promotes specific policy objectives (gender quality, environmental sustainability, and aid for trade), and to monitor donors' compliance with various international recommendations in the field of development cooperation and the debt of developing economies. Major creditor economies, primarily the 23 member economies—at the time of writing the *Guide*— of the Development Assistance Committee (DAC), together with the European Commission, other donors, and international organizations supply information.(See www.oecd.org/dac/stats/data).

#### **Cross-Border Positions**

Asset and liability positions of residents of an economy vis-à-vis residents of all other economies.

#### **Currency of Denomination**

The *currency of denomination* is determined by the currency in which the value of flows and positions is fixed as specified in the contract between parties. Accordingly, all cash flows are determined using the currency of denomination and, if necessary, converted into the domestic currency or another unit of account for the purpose of settlement or compilation accounts. The currency of denomination is important for distinguishing transaction values and holding gains and losses.

## **Currency of Reporting**

The unit of account in which amounts are reported either to the compiling agency and/or to an international agency compiling debt statistics. See Chapter 2 for details on unit of account.

#### **Currency of Settlement**

The currency of settlement is determined by the currency in which the values of the flows and positions are settled. It is important for international liquidity and measurement of potential foreign exchange drains. The currency of settlement may be different from the currency of denomination. Using a currency of settlement that is different from the currency of

denomination simply means that a currency conversion is involved each time a settlement occurs. The currency of settlement is important for international liquidity and measurement of potential foreign exchange drains.

## **Currency of Transaction**

The medium of exchange in which an individual transaction occurs. It may be currency, goods, or services. The medium of exchange of one transaction (for example, disbursement) does not necessarily determine the medium of exchange of another (for example, repayment).

## **Current Account**

The current account covers all transactions of goods, services, primary income, and secondary income between residents and nonresidents. The current account balance shows the difference between the sum of exports and income receivable and the sum of imports and income payable (exports and imports refer to both goods and services, while income refers to both primary and secondary income). The value of the current account balance equals the saving-investment gap for the economy.

## **Current Maturities**

In the context of restructuring agreements, *principal* and *interest* payments falling due in the *consolidation period*.

## **Current Transfers**

Current transfers are all transfers—that is, the transfer of a real resource or a financial item without a quid pro quo—that are not transfers of capital. Current transfers directly affect the level of disposable income and should influence the consumption of goods and services. Current transfers are classified in the secondary income account of the balance of payments.

## **Cutoff Date**

The date (established at the time of a country's first Paris Club *debt reorganization/restructuring*) before which loans must have been contracted in order for their *debt service* to be eligible for restructuring. New loans extended after the cutoff date are protected from future restructuring (*subordination strategy*). In exceptional cases, arrears on post-cutoff-date debt can be deferred over short periods of time in restructuring agreements.

## D

## **De Minimis Creditors (or Clause)**

Minor creditors that are exempted from *debt restructuring* to simplify implementation of the Paris Club restructuring agreements. Their claims are payable in full as they fall due. An exposure limit defining a minor creditor is specified in each *Agreed Minute*.

## Debt- and Debt-Service-Reduction (DDSR) Operations

*Debt-restructuring* agreements are typically undertaken for bank loan debt obligations and involve the buyback and exchange of *eligible debt* either for financial instruments that are valued at a substantial discount (simple cash buyback) or for new bonds featuring a *present value* reduction. In some instances, the principal portion of new financial instruments is fully collateralized with zero-coupon bonds issued by the treasury of an advanced economy, while interest obligations are also partially secured. DDSR operations are characterized by a "menu approach," allowing individual creditors to select from among several DDSR options. Under the Brady Plan of March 1989, some of these arrangements have been supported by loans from official creditors.

## **Debt Assumption**

Debt assumption is a trilateral agreement between a creditor, a former debtor, and a new debtor under which the new debtor assumes the former debtor's outstanding liability to the creditor and is liable for repayment of the debt. The activation of a guarantee is an example of debt assumption.

## **Debt Buyback**

The repurchase by a debtor of its own debt, usually at a substantial discount. The debtor's obligations are reduced while the *creditor* receives a once-and-for-all payment. Although in apparent contravention of standard commercial bank loan agreements, some debtors have bought back their own debt on the secondary market.

## **Debt Conversion**

The exchange of debt for a nondebt liability, such as equity, or for counterpart funds can be used to finance a particular project or policy.

## **Debt Default**

Failure to meet a debt obligation payment, either *principal* or *interest*. A payment that is overdue or in arrears is technically "in default," since by virtue of nonpayment the borrower has failed to abide by the terms and conditions of the debt obligation. In practice, the point at which a debt obligation is considered "in default" will vary.

## **Debt-for-Charity Swap**

The purchase by a nonprofit organization such as a nongovernmental organization (NGO) of the *external debt* of an economy at a discount in the secondary market, which the NGO then exchanges for local currency to be used for philanthropic purposes.

#### **Debt-for-Commodity Swap**

The repayment in kind by a debtor economy of all or part of its *external debt*. Typically, the lender takes a specific, earmarked percentage of the receipts from the exports of a particular

commodity or group of commodities to service the debt.

## **Debt-for-Development Swap**

Financing part of a development project through the exchange of a foreign-currencydenominated debt for local currency, typically at a substantial discount. The process normally involves a foreign nongovernmental organization (NGO) that purchases the debt from the original creditor at a substantial discount using its own foreign currency resources, and then resells it to the debtor economy government for the local currency equivalent (resulting in a further discount). The NGO in turn spends the money on a development project, previously agreed upon with the debtor economy government.

## **Debt-for-Equity Swap**

A transaction in which debt of an economy is exchanged, usually at a discount, for equity in an enterprise in the same economy. Although variable in form, such arrangements usually result in the extinction of a fixed-rate liability (for example, a debt security or loan) denominated in foreign currency and the creation of an equity liability (denominated in domestic currency) to a nonresident. There may be clauses in the agreement to prevent the repatriation of capital before some specified future date.

## **Debt-for-Nature Swap**

Similar to a debt-for-development swap, except that the funds are used for projects that improve the environment.

## **Debt Forgiveness**

The voluntary cancellation of all or part of a debt within a contractual arrangement between a *creditor* in one economy and a debtor in another economy.

## **Debt Instrument(s)**

Existing *debt instruments* typically arise out of contractual relationships under which an institutional unit (the *debtor*) has an unconditional liability to another institutional unit (the *creditor*) to repay principal with or without interest, or to pay interest without principal. These instruments include SDRs, currency and deposits, debt securities, loans, trade credit and advances, insurance, pension, and standardized guarantee schemes and other accounts payable/receivable-other. Debt instruments may also be created by the force of law—in particular, obligations to pay taxes or to make other compulsory payments—or through rights and obligations that results in a debtor accepting an obligation to make future payment(s) to a *creditor*.

## **Debt-Reduction Option**

Option under concessional Paris Club *debt restructurings* where *creditors* effect the required debt reduction in *present value* terms through a reduction of the *principal* of the *consolidated amount*. A commercial *interest* rate and standard repayment terms apply to the

remaining amounts. (See Concessional Restructuring.)

## **Debt Refinancing**

*Debt refinancing* refers to the conversion of the original debt including arrears, into a new *debt instrument*. In other words, overdue payments or future *debt-service* obligations are "paid off" using a new debt obligation. In the *Guide*, as in *BPM6*, a change in the terms of a debt instrument is to be reported as the creation of a new debt instrument, with the original debt extinguished.

## **Debt Relief**

Any form of *debt reorganization* that relieves the overall burden of debt. *Debt relief* results where there is a reduction in the *present value* of these *debt-service* obligations and/or a deferral of the payments due, thus providing smaller near-term debt-service obligations. This can be measured, in most cases, by an increase in the duration of these obligations; that is, payments become weighted more toward the latter part of the *debt instrument*'s life. However, if debt reorganization results in changes in present value and duration that are countervailing in their impact on the debt burden, then there is no debt relief, unless the net impact is significant—such as could occur if there was a deep reduction in present value (together with small decrease in duration) or a sharp increase in duration (together with a small increase in present value).

## **Debt Reorganization/Restructuring**

*Debt reorganization* (also referred to as debt restructuring) is defined as arrangements involving both the creditor and the debtor (and sometimes third parties) that alter the terms established for servicing an existing debt. Types of debt reorganization include debt rescheduling, refinancing, forgiveness, conversion, prepayments, and assumption.

## **Debt Rescheduling**

*Debt rescheduling* refers to the formal deferment of *debt-service* payments and the application of new and extended maturities to the deferred amount. Rescheduling debt is one means of providing a debtor with *debt relief* through a delay and, in the case of concessional rescheduling, a reduction in debt-service obligations.

## **Debt Service**

Refers to payments in respect of both *principal* and *interest*. Actual *debt service* is the set of payments actually made to satisfy a debt obligation, including principal, interest, and any late payment fees. Scheduled debt service is the set of payments, including principal and interest, which is required to be made through the life of the debt.

## **Debt-Service (-to-Exports) Ratio**

The ratio of debt service (*interest* and *principal* payments due) during a year, expressed as a percentage of exports (typically of goods and services) for that year. Forward-looking debt-

service ratios require some forecast of export earnings. This ratio is considered to be a key indicator of an economy's debt burden.

## **Debt-Service-Reduction Option**

Option under concessional Paris Club *debt reschedulings* where *creditors* effect the required debt reduction in *present value* terms through a reduction in the applicable interest rate. (See *Concessional Restructuring*.)

## **Debt-Sustainability Analysis**

A study of an economy's medium- to long-term debt situation. An economy's eligibility for support under the *HIPC Initiative* is determined on the basis of such an analysis, jointly undertaken by the staffs of the IMF, the World Bank, and the economy concerned.

## **Debt-Sustainability Framework (DSF)**

The joint IMF-World Bank Debt Sustainability Framework (DSF) was introduced in April 2005, and is periodically reviewed (most recently in February 2012) and provides a formal framework for conducting dent sustainability analyses in low-income countries. The DSF is designed to guide the borrowing decisions of low-income countries (LICs) in a way that matches their financing needs with their current and prospective repayment ability, taking into account each country's circumstances. The DSF also provides guidance for creditors' lending and grant-allocation decisions to ensure that resources are provided to LICs on terms that are consistent with both progress towards their development goals and long-term debt sustainability. It also improves World Bank and IMF assessments, policy advice and program design in these areas, and helps detect potential crises early so that preventive action can be taken. Under the DSF, debt sustainability analyses (DSAs) are conducted regularly. The Fund has adopted a systematic approach to assessing public and external debt sustainability, which generally differentiates between market-access countries, that have significant access to international capital markets, and LICs, which meet their external financing needs mostly through concessional resources. The sustainability assessments for public and external debt of both types of countries are conducted in the context of both IMF program design and Article IV surveillance.

## **Debt Swaps**

Debt swaps are exchanges of debt, such as loans or debt securities, for a new debt contract (that is, debt-to-debt swaps), or exchanges of *debt-for-equity*, debt for-exports, or debt-for-domestic currency, such as to be used for projects in the debtor economy (also known as *debt conversion*).

## **Debt Workout**

The process of working out a satisfactory method whereby the debtor economy can repay external debt, including restructuring, adjustment, and the provision of new money.

## **Debt Write-Offs**

Debt write-offs are unilateral actions through which a creditor can reduce the value of its debt claims on the debtor in its own books. Write-offs may arise, for instance, when the creditor regards a claim as unrecoverable, perhaps because of bankruptcy of the debtor, and so no longer carries it on its books. The corresponding liability should also be removed from the balance sheet of the debtor.

## Debtor and Creditor Approach for defining and measuring interest for debt securities

Under the *debtor* approach, when debt securities are issued at a fixed rate, the rate of *interest* (original yield-to-maturity) payable, and accruing, is fixed at the time the debt security is issued. Under the creditor approach, the prevailing market rate during the period is used to determine the interest (current yield-to-maturity) paid on a debt security (see *BPM6*, paragraph 11.52).

## **Debtor Economy**

The economy in which the debtor resides.

## **Debtor Reporting System (DRS)**

The World Bank collects through the Debtor Reporting System (DRS) data on external indebtedness from debtor countries that have received either a World Bank loan or an International Development Association (IDA) credit. These data form the core of the detailed country-level debt stock and flow data that are published annually in the *Global Development Finance (GDF) publication*.

## **Decision Point**

In the context of the *HIPC Initiative*, the point at which a economy's eligibility for assistance is determined by the IMF and World Bank Executive Boards on the basis of a *debt-sustainability analysis* and three years of sound performance under IMF- and World Bank-supported adjustment programs. The international community enters into a commitment at the *decision point* to deliver assistance at the *completion point*, provided that the *debtor* adheres to its policy commitments. The debt-sustainability analysis is essentially a medium-term *balance of payments* projection that assesses the debt burden of the economy and its capacity to service those obligations. If external debt ratios for that economy fall within or above applicable targets, it will be considered for special assistance: the target is 150 percent for the ratio of the *present value* of debt to exports, with exceptions to this target in the special case of very open economies with a high debt burden in relation to fiscal revenues. (See also *Completion Point*.)

At the decision point, the Executive Boards of the IMF and World Bank will formally decide on an economy's eligibility, and the international community will commit to provide sufficient assistance by the completion point for the economy to achieve debt sustainability calculated at the decision point. The delivery of assistance committed by the IMF and Bank will depend on satisfactory assurances of action by other creditors.

## **Deferred Payments**

In the context of Paris Club *debt reschedulings*, obligations that are not consolidated but postponed nonconcessionally, usually for a short time, as specified in the *Agreed Minute*.

#### **Development Assistance Committee (DAC) of the OECD**

Since the early 1960s the OECD Development Assistance Committee (DAC) has grouped the world's main donors, defining and monitoring global standards in key areas of development and is a unique forum for sharing views and exchanging lessons. Through wide-ranging partnerships for development, the DAC tracks development finance, helping to make sure the finance is invested effectively and promotes good policy. Over the years, the DAC has worked to provide innovative and integrated approaches to a range of development challenges - from climate change to conflict and gender equality, and played a role in forging major international development commitments, including the Millennium Development Goals and the Paris Declaration on Aid Effectiveness. The DAC periodically reviews both the amount and the nature of its members' contributions to aid programs, both bilateral and multilateral. The DAC does not disburse assistance funds directly, but is concerned instead with promoting increased assistance efforts by its members. The members of the DAC are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Korea, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States, and the European Union.(See www.oecd.org/dac)

## **Direct Investment Enterprise**

An entity subject to control or a significant degree of influence by a *direct investor*. Control or influence may be achieved directly by owning equity that gives voting power in the enterprise, or indirectly by having voting power in another enterprise that has voting power in the enterprise (See *BPM6*, paragraphs 6.11 and 6.12).

## **Direct Investor**

An entity or group of related entities that is able to exercise control or significant degree of influence over another entity that is resident of a different economy. Control or influence may be achieved directly by owning equity that gives voting power in the enterprise, or indirectly by having voting power in another enterprise that has voting power in the enterprise (See *BPM6*, paragraphs 6.11 and 6.12).

#### **Disbursed Loans**

The amount that has been disbursed from a loan but has not yet been repaid or forgiven.

## Disbursements

The transactions of providing financial resources. The two counterparties must record the transaction simultaneously. In practice, disbursements are recorded at one of several stages: provision of goods and services (where trade credit is involved); placing of funds at the

disposal of the recipient in an earmarked fund or account; withdrawal of funds by the recipient from an earmarked fund or account; or payment by the lender of invoices on behalf of the borrower. The term "utilized" may apply when the credit extended is in a form other than currency. Disbursements should be recorded gross—the actual amount disbursed.

#### **Domestic Currency**

Domestic currency is that which is legal tender in the economy and issued by the monetary authority for that economy; that is, either that of an individual economy or, in a currency union, that of the common currency area to which the economy belongs. All other currencies are foreign currencies.

## Duration

Duration is the weighted average term to maturity of a *debt instrument*. The time period until the receipt/ payment of each cash flow, such as six months, is weighted by the *present value* of that cash flow, as a proportion of the present value of total cash flows over the life of the instrument. Present value can be calculated using the yield-to-maturity or another *interest* rate. The more the cash flows are concentrated toward the early part of a debt instrument's life, the shorter the duration relative to the time to maturity.

## E

## **Eligible Debt or Debt Service**

In the context of the Paris Club, debt that can be rescheduled—namely, debt that is contracted before the *cutoff date*, with maturities of one year or longer.

## **Enhanced Concessions (or Enhanced Toronto Terms)**

See Concessional Restructuring.

## Enhanced Structural Adjustment Facility (ESAF)

See *Structural Adjustment Facility* (SAF). Renamed the *Poverty Reduction and Growth Facility* (PRGF) in November 1999.

#### **ESAF-HIPC Trust**

A trust established by the IMF in February 1997 to provide assistance to the countries deemed eligible for assistance under the *HIPC Initiative* by the Boards of the IMF and the World Bank. Through this trust, the IMF will provide grants (or, in exceptional circumstances, highly concessional loans) that will be used to retire an economy's obligations falling due to the IMF after the *completion point*.

#### **Escrow Accounts**

In the context of external debt payments, accounts typically held in banks outside of the
*debtor economy* through which a portion of the export proceeds of a *debtor* is channeled. Typically involve balances of one-year maturity to cover future *debt-service* payments. *Creditors* who are the beneficiaries of such accounts thus obtain extra security for their loans and effective priority in *debt service*.

## **Exceptional Financing**

As an alternative to—or in conjunction with—the use of reserve assets, IMF credit and loans, and liabilities constituting foreign authorities' reserves, to deal with payments imbalance, *exceptional financing* denotes any other arrangements made by the authorities of an economy to finance *balance of payments* needs. The identification of exceptional financing transactions is linked to an analytical concept rather than being based on precise criteria. Among the transactions regarded as exceptional financing transactions are *debt forgiveness, debt-for-equity swaps*, and other types of transactions relating to *debt reorganizations*. Under certain circumstances, some borrowings by the government or other sectors might meet the criterion.

## **Export Credit**

A loan extended to finance a specific purchase of goods or services from within the *creditor economy*. *Export credits* extended by the supplier of goods—such as when the importer of goods and services is allowed to defer payment— are known as *supplier's credits*; export credits extended by a financial institution, or an *export credit agency* in the exporting economy are known as *buyer's credits*. (See also *Officially Supported Export Credits*.)

## **Export Credit Agency**

An agency in a *creditor economy* that provides insurance, guarantees, or loans for the export of goods and services.

## **Extended Credit Facility (ECF)**

The ECF is an IMF lending facility that succeeds the Poverty Reduction and Growth Facility (PRGF) as the Fund's main tool for providing medium-term support to low income countries with protracted balance of payments problems. Financing under the ECF currently carries a zero interest rate, with a grace period of 5½ years, and a final maturity of 10 years.

## **Extended Fund Facility (EFF)**

This IMF lending facility was established in 1974 to assist countries address longer-term *balance of payments* problems reflecting extensive distortions that require fundamental economic reforms. Arrangements under the EFF are thus longer than Stand-By Arrangements—usually 3 years. Repayment is due within 4½–10 years from the date of disbursement. (See *Stand-By Arrangement*.).

## **External Debt (Gross External Debt)**

Gross external debt, at any given time, is the outstanding amount of those actual current, and

not contingent, liabilities that require payment(s) of *interest* and/or *principal* by the *debtor* at some point(s) in the future and that are owed to nonresidents by residents of an economy.

#### F

## **Face Value**

Face value is the undiscounted amount of principal to be paid to the holder at maturity (for example, the redemption amount of a bond). Sometimes called initial contractual value, for loans, the *face value* is the original amount of the loan as stated in the loan contract. If the loan is not fully disbursed, then the face value will include future disbursements, just as the face value of a zero-coupon bond includes *interest* that has not yet accrued. It is also known as "par value' or simply "par".

#### **Fair Value**

Fair value of a debt instrument is a market-equivalent value. It is defined as the amount for which an asset could be exchanged, or a liability settled between knowable, willing parties in an arm's-length transaction. Therefore, it represents an estimate of what could be obtained if the creditor had sold the financial claim.

#### **Fellow Enterprises**

See Affiliates.

#### **Financial Account**

The *financial account* of the *balance of payments* consists of the transactions in foreign financial assets and liabilities of an economy. The foreign financial assets of an economy consist of holdings of monetary gold, IMF Special Drawing Rights (holdings), and claims on nonresidents. The foreign liabilities of an economy consist of claims of nonresidents on residents and IMF Special Drawing Rights (allocations). The primary basis for classification of the financial account is functional: direct, portfolio, and other investment, financial derivatives, and reserve assets.

#### **Financial Assets**

Financial assets are stores of value, over which ownership rights are enforced and from which their owners may derive economic benefits—such as property income and/or holding gains and losses—by holding them over a period of time. Financial assets consist of claims in respect of equity and investment fund shares, debt instruments, financial derivatives and ESOs and the gold bullion component of monetary gold.

#### **Financial Claim**

A *financial claim* (1) entitles a *creditor* to receive a payment, or payments, from a *debtor* in circumstances specified in a contract between them; or (2) specifies between the two parties certain rights or obligations, the nature of which requires them to be treated as financial.

#### **Financial Derivatives**

*Financial derivatives* are financial instruments that are linked to a specific financial instrument or indicator or commodity, and through which specific financial risks can be traded in financial markets in their own right. The value of a financial derivative derives from the price of an underlying item, such as an asset or index. Unlike *debt instruments*, no principal amount is advanced to be repaid, and no investment income accrues. Financial derivatives are used for a number of purposes including risk management, hedging, *arbitrage* between markets, and speculation. Transactions in financial derivatives should be treated as separate transactions rather than integral parts of the value of underlying transactions to which they may be linked.

## **Financial Liability**

A financial liability (1) requires a *debtor* to make a payment, or payments, to a *creditor* in circumstances specified in a contract between them; or (2) specifies between the two parties certain rights or obligations, the nature of which requires them to be treated as financial.

## **Flag-of-Convenience Countries**

Countries with favorable tax rules and other regulations attracting corporations whose main business (originally, primarily shipping—but increasingly, production or services) is outside the economy.

## Flexible Credit Line (FCL)

The FCL is an IMF credit facility designed to meet the increased demand for crisis-prevention and crisis-mitigation lending from countries with robust policy frameworks and very strong track records in economic performance. FCL arrangements are requested by member countries and are approved by the IMF Executive Board, for countries meeting pre-set qualification criteria. The length of the FCL is 1-2 years (with an interim review of continued qualification after 1 year) and the repayment period the same as for the SBA. Access is determined on a caseby-case basis, is not subject to the normal access limits, and is available in a single up-front disbursement rather than phased. Disbursements under the FCL are not conditioned on implementation of specific policy understandings as is the case under the SBA. There is flexibility to either draw on the credit line at the time it is approved or treat it as precautionary. In case a member draws, the repayment terms are the same as that under the SBA.

## **Flow Rescheduling**

In the context of the Paris Club, the rescheduling of specified *debt service* falling due during the *consolidation period* and, in some cases, of specified arrears outstanding at the beginning of the consolidation period. (See *Stock-of-Debt Operation*.)

## **Foreign Currency**

In this Guide, a foreign currency is a currency other than the domestic currency.

#### Forfaiting

A mechanism, most commonly used in medium- and long-term credit, involving the purchase of promissory notes or bills of exchange by the forfaiter, at a discount. Banks or other financial services entities often own forfait companies.

## **Fund Credit**

See Use of IMF Credit and Loans in Appendix I.

## G

## Geographical Distribution of the Financial Flows to Developing Countries (Annual)

An annual publication of the OECD that provides comprehensive data on the volume, origin and types of aid and other resource flows to around 150 developing countries. The data show each country's intake of official development assistance and well as other official and private funds from members of the Development Assistance Committee of the OECD, multilateral agencies and other key donors. Key development indicators are provided for reference.

## **Goodwill Clause**

Clause used in Paris Club agreements under which *creditors* agree in principle, but without commitment, to consider favorably subsequent *debt-relief* agreements for a *debtor economy* that remains in compliance with the restructuring agreement as well as with its IMF arrangement, and has sought comparable debt relief from other creditors. The clause can be intended for a future flow restructuring or a *stock-of-debt operation*.

## **Grace Period and Maturity**

The grace period for *principal* is the period from the date of signature of the loan or the issue of the financial instrument to the first repayment of principal. The repayment period is the period from the first to last repayment of principal. Maturity is the sum of both periods: grace plus repayment periods.

## Graduated Payments (or "Blended Payments")

In the context of Paris Club reschedulings, the term refers to a repayment schedule where *principal* repayments gradually increase over the repayment period, reflecting an expected improvement in the repayment capacity of a *debtor economy*. *Creditors* have made increasing use of the graduated payments, replacing flat payment schedules where equal amounts of principal repayments were made over the repayment period: from the creditor perspective, graduated payments provide for principal repayments starting earlier, and, from the *debtor* perspective, they avoid a large jump in *debt service*.

## **Grant Element**

Measure of the concessionality of a loan, calculated as the difference between the *face value* of the loan and the sum of the discounted future *debt-service* payments to be made by the borrower expressed as a percentage of the face value of the loan. A 10 percent rate of discount is used by the Development Assistance Committee (DAC) and the World Bank to measure the grant element of official loans. (See also *Development Assistance Committee*, *Concessionality Level*, and *Official Development Assistance*.)

# **Grant-Like Flows**

Loans for which the original agreement stipulates that payments to service the debt are to be placed into an account in the borrowing economy and used in the borrowing economy to the benefit of that economy. These transactions are treated as "grants(transfers)" in the OECD-DAC statistics because their repayment does not require a flow of foreign currency across the exchanges. They are nevertheless counted as *external debt* because the *creditor* is nonresident. (The classification of these transactions as transfers is not consistent with *BPM6* recommendations. In *BPM6*, transfers are regarded as transactions where a real resource or financial item is provided but no quid pro quo is received. In the above transaction, in return for a reduction in outstanding debt, domestic currency is provided.)

## **Gross Domestic Product (GDP)**

Essentially, the sum of the gross value added of all resident producer units plus that part (possibly the total) of taxes on products, less subsidies on products, that is not included in the valuation of output. For further details, see *2008 SNA*, paragraphs 2.138–2.140.

## **Gross National Income (GNI)**

GDP plus net primary income from abroad. For further details, see 2008 SNA, paragraphs 2.143-2.145.

# H

# Heavily Indebted Poor Countries (HIPCs)

Group of developing countries (economies) classified as being heavily indebted poor countries. These are those countries that are eligible for highly concessional assistance from the *International Development Association* (IDA), and from the IMF's *Poverty Reduction and Growth Facility* (PRGF, previously the Enhanced Structural Adjustment Facility, ESAF), and that face an unsustainable debt situation even after the full application of traditional *debt-relief* mechanisms.

## Helsinki Package

Agreement that came into force in 1992. This agreement prohibits (with some exceptions) the provision of *tied aid loans* to *high-income countries* (based on World Bank per capita income), and for commercially viable projects. (See also *Arrangement on Guidelines for* 

#### Officially Supported Export Credits.)

#### **High-Income Countries**

The World Bank classifies as high-income those countries with *GNI* per capita income of \$12,276 or more in 2010. Income classifications are set each year on July 1, and are fixed during the period ending on June 30 of the following year.

#### **HIPC Initiative**

Framework for action to resolve the external debt problems of *heavily indebted poor countries* (HIPCs) that was developed jointly by the IMF and the World Bank and was adopted in September 1996. The Initiative envisaged comprehensive action by the international financial community, including multilateral financial institutions, to reduce to sustainable levels the *external debt* burden on HIPCs, provided they build a track record of strong policy performance.

Following a comprehensive review of the HIPC Initiative, a number of modifications to the Initiative were approved in September 1999 to provide faster, deeper, and broader *debt relief* and strengthen the links between debt relief, poverty reduction, and social policies.

In 2005, to help accelerate progress toward the UN Millennium Development Goals, the HIPC initiative was supplemented by the Multilateral Debt Relief Initiative (MDRI).

#### **HIPC Trust Fund**

The Trust Fund administered by the International Development Association (IDA) to provide grants to eligible *heavily indebted poor countries* (HIPCs) for relief on debt owed to participating multi-laterals. The Trust Fund will either prepay, or purchase, a portion of the debt owed to a multilateral creditor and cancel such debt, or pay *debt service*, as it comes due. The HIPC Trust Fund receives contributions from participating multilateral creditors and from bilateral donors. Contributions can be earmarked for debt owed by a particular debtor or to a particular multilateral creditor. Donors can also provide contributions to an unallocated pool and participate in decisions regarding the use of these unallocated funds. The Trust Fund allows multilateral creditors to participate in the Trust Fund in ways consistent with their financial policies and aims to address the resource constraints for certain multilateral creditors. (See also *ESAF-HIPC Trust*.)

#### **Home Economy**

The economy of residence of the head office of the institutional unit.

#### **Host Economy**

The economy in which the institutional unit is located.

## **Houston Terms**

See Lower-Middle-Income-Country Terms.

# I

# **IMF Adjustment Program**

An adjustment program in a member country of the IMF. An IMF-supported program is a detailed economic program that is based on an analysis of the economic problems of the member country. It specifies the policies being implemented or that will be implemented by the country in the monetary, fiscal, external, and structural areas, as necessary, in order to achieve economic stabilization and set the basis for self-sustained economic growth. It usually, though not necessarily, refers to a program that is supported by the use of IMF resources.

## **IMF** Arrangement

Agreement between the IMF and a member country on the basis of which the IMF provides financial assistance to a member country seeking to redress its *balance of payments* problems and to help cushion the impact of adjustment. See *Appendix I, Use of IMF Credit and Loans*.

## **Institutional Sector**

The grouping of institutional units with common economic objectives and functions. (See also Sector Classification.)

## **Institutional Unit**

In the 2008 SNA, institutional units are the entities that undertake the activities of production, consumption, and the accumulation of assets and liabilities. In other words, economic activity involves transactions among institutional units be they households or corporations. An institutional unit is defined in the 2008 SNA as "an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities" (2008 SNA, paragraph 4.2).

## Insured (Guaranteed) Export Credit

An *export credit* that carries a guarantee, issued by an *export credit agency*, protecting the *creditor* against *political*, *commercial*, or *transfer risks* in the *debtor economy* that may prevent the remittance of *debt-service* payments. (See also *Export Credit Agency*.)

## **Interbank Positions**

Asset and liability positions that banks have with other banks.

#### Interest

For the use of *principal*, *interest* can, and usually does, accrue on the principal amount, resulting in an interest cost for the *debtor*. When this cost is paid periodically, as commonly occurs, it is known in this *Guide* as an interest payment. Interest can be calculated either on a fixed-interest-rate or on a variable-interest-rate basis. In this *Guide*, in contrast to a fixed interest rate, which remains unchanged over a period of years, a variable interest rate is linked to a reference index (for example, the *London interbank offered rate*, 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. (See also *Principal*.)

#### International Bank for Reconstruction and Development (IBRD)

The International Bank for Reconstruction and Development (IBRD) was set up as an intergovernmental financial institution in 1946 as a result of the Bretton Woods Accord. It is the original agency of the *World Bank Group* and is commonly referred to as the World Bank. (See also *World Bank Group*.)

#### **International Banking Business (BIS Data)**

In the consolidated BIS statistics, international claims are defined as banks' cross-border claims (A) plus local claims of foreign affiliates in foreign currencies (B). Foreign claims are defined as the sum of cross-border claims plus foreign offices' local claims in all currencies. Therefore, on an immediate borrower basis, foreign claims can be calculated as the sum of international claims (A+B) and local claims in local currency (C).

#### **International Development Association (IDA)**

IDA, established in 1960, is the concessional lending arm of the *World Bank Group*. IDA provides low-income developing countries (economies) with long-term loans on highly concessional terms: typically a 10-year grace period, a 40-year repayment period, and only a small servicing charge.

#### **International Interbank Market**

An international money market in which banks lend to each other—either cross-border or locally in foreign currency—large amounts of funds, usually at short term (between overnight and six months).

#### **International Investment Position (IIP)**

The IIP is a statistical statement that shows at a point in time the value and composition of (a) financial assets of residents of an economy that are claims on nonresidents and gold bullion held as reserve assets, and (b) liabilities of residents of an economy to nonresidents. The difference between an economy's external financial assets and liabilities is the economy's net IIP, which may be positive or negative.

## **International Monetary Fund (IMF)**

Following the Bretton Woods Accords and established in 1945, the IMF is a cooperative intergovernmental monetary and financial institution with 187 member countries. Its main purpose is to promote international monetary cooperation so to facilitate the growth of international trade and economic activity more generally. The IMF provides financial resources to enable its members to correct payments imbalances without resorting to trade and payments restrictions.

## **International Security Identification Number (ISIN)**

The ISIN is a unique international security code issued by National Numbering Agencies (NNAs) to securities issued in their jurisdiction. The Association of National Numbering Agencies (ANNA) is the authority responsible for coordinating all aspects of the implementation of the ISIN numbering system. More information on the ISIN code system is available in Appendix VII of the IMF's *Coordinated Portfolio Investment Survey Guide*, 2nd ed. (IMF, 2002).

# J

## Joint Venture

An enterprise in which two or more parties hold major interests.

## L

## Late Interest Charges

The additional *interest* that may be levied on obligations overdue beyond a specified time; in some Paris Club agreements, late interest charges have been specifically excluded from the debt consolidation.

## Leverage

Having exposure to the full benefits arising from holding a position in a financial asset, without having to fully fund the position with own funds.

## Line of Credit

An agreement that creates a facility under which one unit can borrow credit from another up to a specified ceiling usually over a specified period of time. Lines of credit provide a guarantee that funds will be available, but no financial asset/liability exists until funds are actually advanced.

#### Loan Agreement

The legal evidence and terms of a loan.

#### Loan Guarantee

A legally binding agreement under which the guarantor agrees to pay any or all of the amount due on a loan instrument in the event of nonpayment by the borrower.

#### **Locational Banking Statistics (BIS)**

The BIS locational banking statistics gather quarterly data on international financial claims and liabilities of bank offices in the reporting countries. Total positions are broken down by currency, by sector (bank and non-bank), by country of residence of the counterparty and by nationality of reporting banks. Both domestically owned and foreign-owned banking offices in the reporting countries record their positions on a gross (unconsolidated) basis, including those vis-à-vis own affiliates in other countries. This is consistent with the residency principle of national accounts, balance of payments and external debt statistics.

## London Club

A group of commercial banks whose representatives meet periodically to negotiate the restructuring of debts of sovereign borrowers. There is no organizational framework for the London Club comparable to that of the Paris Club.

#### London Interbank Offered Rate (LIBOR)

The London interbank offered rate for deposits, such as the six-month dollar *LIBOR*. LIBOR is a reference rate for the international banking markets and is commonly the basis on which lending margins are fixed. Thus, an original loan agreement or a *rescheduling agreement* may set the *interest* rate to the borrower at six-month dollar LIBOR plus 1.5 percent, with semiannual adjustments for changes in the LIBOR rate. In addition, interest rate swap rates are quoted in reference to LIBOR; that is, the quoted rate is the fixed-rate side of the swap because the floating-rate side is LIBOR.

#### **London Terms**

See Concessional Restructuring.

#### **Long-Maturities Option**

In the context of the Paris Club, an option under which the consolidated amount is rescheduled over a long period of time, but without a reduction in the *present value* of the debt.

#### **Long-Term External Debt**

External debt that has a maturity of more than one year. Maturity can be defined either on an original or remaining basis. (See also *Original Maturity* and *Remaining Maturity*.)

#### **Low-Income Countries**

In the context of the Paris Club, countries eligible to receive concessional terms. The Paris Club decides eligibility on a case-by-case basis, but only countries eligible to receive highly concessional IDA credits from the *World Bank Group* are included. The World Bank classifies as low-income those countries with *GNI* per capita income of \$1,005 or less in 2010. Income classifications are set each year on July 1, and are fixed during the period ending on June 30 of the following year.

## Lower-Middle-Income-Country Terms

In the context of the Paris Club, refers to the rescheduling terms granted, since September 1990, to lower-middle-income countries. These terms are nonconcessional and originally provided for flat repayment schedules, but in recent years graduated payment schedules have often been agreed upon for *commercial credits*, namely, with a maturity of up to 18 years, including a grace period of up to 8 years.

Official development assistance credits are rescheduled over 20 years, including a grace period of up to 10 years. This set of rescheduling terms also includes the limited use of debt swaps on a voluntary basis. The World Bank classifies as lower-middle income those countries with *GNI* per capita income of between \$1,006 and \$3,975 in 2010. Income classifications are set each year on July 1, and are fixed during the period ending on June 30 of the following year.

# Lyon Terms

See Concessional Restructuring.

## $\mathbf{M}$

## **Market Valuation**

Amounts of money that willing buyers pay to acquire something from willing sellers; the exchanges are made between independent parties on the basis of commercial considerations only. The market value of a *debt instrument* should be based on the market price for that instrument prevailing at the time to which the position statement refers; that is, current market prices as of the dates involved (beginning or end of the reference period). Chapter 2 provides more details. (See also *Nominal Value*.)

## **Maturity Date (Final)**

The date on which a debt obligation is contracted to be extinguished. (See also *Original Maturity* and *Remaining Maturity*.)

## **Maturity Structure**

A time profile of the maturities of claims or liabilities. Also known as "maturity profile" or "maturity distribution."

#### **Millennium Development Goals**

The Millennium Development Goals (MDGs) are eight goals – which range from halving extreme poverty to halting the spread of HIV/AIDS and providing universal primary education, all by the target date of 2015 –agreed to by all the world's countries and all the world's leading development institutions.

## **Mixed Credits**

A credit that contains an aid element, so as to provide concessional credit terms—such as a lower rate of interest or a longer credit period.

## **Moratorium Interest**

*Interest* charged on rescheduled debt. In the Paris Club, moratorium interest rates are negotiated bilaterally between the *debtor* and *creditor countries* and thus can differ among *creditors*. In the London Club, where all creditors are deemed to have access to funds at comparable rates, the moratorium interest rate applies equally to all rescheduled obligations under an agreement.

## **Multilateral Creditors**

These creditors are multilateral financial institutions such as the IMF and the World Bank, as well as other multilateral development banks.

## Multilateral Debt Relief Initiative (MDRI)

The HIPC Initiative entailed coordinated action by multilateral organizations and governments to reduce to sustainable levels the external debt burdens of the most heavily indebted poor countries. The Multilateral Debt Relief Initiative (MDRI) goes further and provides for 100 percent relief to a group of low-income countries on eligible debt (debt claims on countries that have reached, or will eventually reach, the HIPC completion point) from the IMF, the International Development Association (IDA) of the World Bank, and the African Development Fund (AfDF). The initiative is intended to help the low-income countries advance toward the United Nations' Millennium Development Goals (MDGs), which are focused on halving poverty by 2015.

## Multiyear Rescheduling Agreement (MYRA)

An agreement granted by official creditors that covers *consolidation periods* of two or more years in accordance with multiyear *IMF arrangements*, such as the *Extended Fund Facility* (EFF) and the *Poverty Reduction and Growth Facility* (PRGF). The modalities of the agreement are that a succession of shorter consolidations (*tranches*) are implemented after certain conditions specified in the *Agreed Minute* are satisfied, such as full implementation to date of the *rescheduling agreement* and continued implementation of the IMF arrangements.

## Ν

## **Naples Terms**

See Concessional Restructuring.

## Nationality

Economy of residence of the head office of an institutional entity.

## National Numbering Agencies (NNAs)

NNAs have the sole right to allocate *International Security Identification Number* (ISIN) codes to securities within their own jurisdiction.

## **Net Flow**

From the viewpoint of a loan, the net flow is gross disbursements less principal repayments.

## Net Present Value (NPV) of Debt

The nominal amount outstanding minus the sum of all future *debt-service* obligations (*interest* and *principal*) on existing debt discounted at an interest rate different from the contracted rate.

The concept is closely related to that of opportunity cost: if the *debtor* has a loan that bears a 3 percent rate of interest, it is clear that the debtor is better off than by borrowing at 10 percent. Nevertheless, by discounting the future debt-service obligations at 10 percent and comparing the outcome with the amount borrowed, the NPV will tell how much the opportunity to borrow at 3 percent, rather than at 10 percent, is worth to the debtor. The NPV can be used to assess the profitability of buying back bonds, although account needs to be taken of how the buyback is to be financed.

The *Development Assistance Committee* (DAC) OECD *grant element* is an NPV concept, since the grant element is the percentage that the NPV, using a 10 percent rate of discount, represents of the *face value* of the loan. In the context of the Paris Club and the *HIPC Initiative*, sometimes *present value* is misdescribed as NPV. (See *Present Value, Concessionality Level*, and *Grant Element*.)

## **Net Resource Transfer**

A net resource transfer is a current account deficit excluding any net interest payments.

## **Nominal Value**

The nominal value of a *debt instrument* is the amount that at any moment in time the *debtor* owes to the *creditor* at that moment; this value is typically established by reference to the terms of a contract between the debtor and creditor. The nominal value of a debt instrument reflects the value of the debt at creation, and any subsequent economic flows, such as

transactions (for example, repayment of *principal*), valuation changes (independent of changes in its market price), and other changes. Conceptually, the nominal value of a debt instrument can be calculated by discounting future *interest* and principal payments at the existing contractual interest rate(s) on the instrument; the latter may be fixed-rate or variable-rate. Chapter 2 provides more details. (See also *Market Valuation*.)

#### **Nonconsolidated Debt**

The debt that is wholly or partly excluded from rescheduling. It has to be repaid on the terms on which it was originally borrowed, unless creditors agree otherwise.

#### **Nonperforming Loans**

Defined as those loans for which (a) payments of principal and *interest* are past due by three months (90 days) or more, or (b) interest payments equal to three months (90 days) interest or more have been capitalized (reinvested into principal amount) or payment has been delayed by agreement, or (c) evidence exists to classify a loan as nonperforming even in the absence of a 90 day past due payment, such as when the debtor files for bankruptcy. (See *BPM6*, paragraphs 7.50-7.53). Nonperforming loans are recorded at nominal value.

#### Notional (Nominal) Amount of a Financial Derivatives Contract

The notional amount is that underlying a *financial derivatives* contract and is necessary for calculating payments or receipts, but which may or may not be exchanged.

## 0

## **OECD** Working Party on Export Credits and Credit Guarantees

This is a forum for discussing *export credit* issues and for exchanging information among at the time of publication of the *Guide*— 32 of the 34 member countries of the OECD (only Chile and Iceland do not participate).

## **Official Development Assistance (ODA)**

Official flows to countries and territories on the DAC list of ODA recipients (see www. OECD.org/dac/stats/daclist) and to multilateral development institutions that are administered with the promotion of the economic development and welfare of developing countries as the main objective, and which are concessional in character with a *grant element* of at least 25 percent (using a fixed 10 percent rate of discount). ODA receipts comprise *disbursements* by bilateral donors and multilateral institutions. Lending by *export credit agencies*—with the pure purpose of export promotion—is excluded.

## **Official Development Assistance (ODA) Loans**

Loans with a maturity of over one year meeting the criteria set out in the definition of ODA, provided by governments or official agencies and for which repayment is required in convertible currencies or in kind.

#### **Official Development Bank**

A nonmonetary financial intermediary controlled by the public sector. It primarily engages in making long-term loans that are beyond the capacity or willingness of other financial institutions.

#### **Official Development Finance (ODF)**

Total official flows to developing countries excluding (1) *officially supported export credits*, (2) official support for private export credits (both are regarded as primarily trade promoting rather than development oriented), and (3) grants and loans for nondevelopmental purposes. ODF comprises official development assistance (ODA) and other official development finance flows.

#### **Officially Supported Export Credits**

Loans or credits to finance the export of goods and services for which an official *export credit agency* in the creditor economy provides guarantees, insurance, or direct financing. The financing element—as opposed to the guarantee/insurance element—can be extended by an exporter (supplier's credit), or through a commercial bank in the form of trade-related credit provided either to the supplier, or to the importer (*buyer's credit*). It can also be extended directly by an export credit agency of the exporting countries, usually in the form of medium-term finance as a supplement to resources of the private sector, and generally for export promotion for capital equipment and large-scale, medium-term projects. Under the rules of the *Arrangement on Guidelines for Officially Supported Export Credits* covering *export credits* with duration of two years or more, up to 85 percent of the export contract value can be officially supported.

## **Offshore Financial Center**

Countries or jurisdictions with financial centers that contain financial institutions that deal primarily with nonresidents and/or in foreign currency on a scale out of proportion to the size of the host economy. Nonresident-owned or -controlled institutions play a significant role within the center. The institutions in the center may well gain from tax benefits not available to those outside the center.

#### **One-Off Guarantees**

One-off guarantees occur in situations in which the conditions of the loan or of the security that is guaranteed are so particular that it is not possible for the degree of risk associated with it to be calculated with any degree of precision. They are recognized only as financial assets and liabilities from the time they are activated. (See *BPM6*, paragraph 5.68).

## **Organisation for Economic Co-operation and Development (OECD)**

The mission of the OECD is to promote policies that will improve the economic and social well-being of people around the world. The OECD provides a forum in which governments can work together to share experiences and seek solutions to common problems. It works with

governments to understand what drives economic, social and environmental change and measures productivity and global flows of trade and investment. The OECD analyses and compares data to predict future trends. It sets international standards on a wide range of things, from agriculture and tax to the safety of chemicals.

## **Original Maturity**

The period of time from when the financial asset/liability was created to its final maturity date.

#### **Other Official Flows (OOFs)**

Official flows of a *creditor economy* that are not undertaken for economic development purposes or, if they are mainly for development, whose grant element is below the 25 percent threshold that would make them eligible to be recorded as ODA. They include *export credits* extended or rescheduled by the official sector.

#### **Own Offices**

Different offices of the same entity, including head offices, branch offices, and subsidiaries. Also sometimes called "related offices."

#### Р

#### **Pass Through Funds (Funds in Transit)**

Consist of funds that pass through an enterprise resident in an economy to an affiliate in another economy, so that the funds do not stay in the economy of that enterprise. These funds are often associated with direct investment. Such flows have little impact on the economy they pass through.

#### **Paris Club**

An informal group of creditor governments that has met regularly in Paris since 1956 to provide debt treatment to countries experiencing payment difficulties; the French treasury provides the secretariat. Creditors reschedule a debtor country's public debts as part of the international support provided to an economy that is experiencing debt-servicing difficulties and is pursuing an adjustment program supported by the IMF. The Paris Club includes—at the time of publication of the *Guide*—19 permanent members, associates members, and observers (including the IMF and the WB). The core creditors are mainly OECD member countries, but other creditors may participate as relevant for a debtor economy.

#### **Permanent Debt**

Loan capital that represents a permanent *interest. Permanent debt* between affiliated financial intermediaries is treated in the same way as nonpermanent debt (See *BPM6*, Appendix 8).

## **Political Risk**

The risk of nonpayment on an export contract or project due to action taken by the importer's host government. Such action may include intervention to prevent transfer of payments, cancellation of a license, or events such as war, civil strife, revolution, and other disturbances that prevent the exporter from performing under the supply contract or the buyer from making payment. Sometimes physical disasters such as cyclones, floods, and earthquakes come under this heading.

#### Positions

In contrast to the accounts that show flows, a balance sheet (including the IIP) shows the positions (also known as stocks) of assets and liabilities held at one point in time by each unit or sector or the economy as a whole. Balance sheets are normally constructed at the start and end of an accounting period but they can in principle be constructed at any point in time. Positions result from the accumulation of prior transactions and other flows. (See *2008 SNA* 2.33).

## **Post-Cutoff-Date Debt**

#### See Cutoff Date.

## Poverty Reduction and Growth Facility (PRGF)

An IMF facility known until November 1999 as the *Enhanced Structural Adjustment Facility* (ESAF). The PRGF was replaced by the Extended Credit Facility (EFC), which became operative in January 2010 (see Extended Credit Facility, EFC).

#### **Precautionary and Liquidity Line (PLL)**

The PLL is an IMF credit facility designed to meet flexibly the liquidity needs of member countries with sound economic fundamentals but with some remaining vulnerabilities that preclude them from using the Flexible Credit Line (FCL). The PLL combines qualification (similar to the FCL) with focused ex-post conditions that aim at addressing the identified vulnerabilities in the context of semi-annual monitoring. Duration of PLL arrangements can be either six months or 1-2 years. Access under the six-month PLL is limited to 250 percent of quota in normal times, but this limit can be raised to 500 percent of quota in exceptional circumstances due to exogenous shocks, including heightened regional or global stress. 1-2 year PLL arrangements are subject to an annual access limit of 500 percent of quota and a cumulative limit of 1000 percent of quota. The repayment terms of the PLL are the same as for the SBA.

#### Premium

In the context of *export credits*, the amount paid, usually in advance, by the party to an export agency for its facilities. Cover will often not be fully effective until the *premium* has been paid. Premiums are normally calculated on the basis of the exposure, length of credit, and the riskiness of transacting with the importing economy. Premium income, an important

source of revenue for *export credit agencies*, is intended to cover the risk of nonpayment of the credit.

## Prepayment

The partial or full repayment by the borrower, perhaps at a discount, of an outstanding debt obligation in advance of the maturity date. The prepayment may be at a discount from the current outstanding *principal* amount.

## **Present Value**

The present value is the discounted sum of all future *debt service* at a given rate of *interest*. If the rate of interest is the contractual rate of the debt, by construction, the *present value* equals the *nominal value*, whereas if the rate of interest is the market interest rate, then the present value equals the market value of the debt. In *debt-reorganization* discussions, the present value concept is used to measure, in a consistent manner, the burden sharing of debt reduction among *creditors*. This can be illustrated by the following example.

Debtor A owes 100 to both creditor B and creditor C. The maturity of both loans is the same. Creditor B's loan has an interest rate of 3 percent and that of C an interest rate of 6 percent. The "market rate" is assumed to be 8 percent—that is, B and C could have lent the money at this higher rate. So, for both B and C, the opportunity cost of lending at their respective interest rates, rather than at the market rate, can be calculated by discounting future payments at the market rate of 8 percent (present value), and comparing the outcome with the outstanding nominal value of 100. If PV(B) represents the present value for B and PV(C) represents the present value for C, then:

PV(B) < PV(C) < 100

PV(B) is less than PV(C) because the size of the future payments to be made by A to B is less than those to be made to C. In turn, the payments by A to C are less than would have been the case if a market rate of interest had been charged. This is illustrated by the annual interest payments. Debtor A would annually pay 3 to B; 6 to C; and 8 at the market rate of interest.

In deciding upon burden sharing of debt reduction, since B's claims on A are already lower than those of C, despite the same nominal value, debt reduction required from B might well be less than that required from C. So, it can be seen that by using a common interest rate to discount future payments, the burden on the debtor of each loan can be quantified in a comparable manner.

# Present Value of Debt-to-Exports Ratio (PV/X)

*Present value* (PV) of debt as a percentage of exports (usually of goods and services) (X). In the context of the Paris Club and *HIPC Initiative*, sometimes present value is misdescribed as *net present value* (NPV). In this context NPV/X has the same meaning as PV/X.

#### **Previously Rescheduled Debt**

Debt that has been rescheduled on a prior occasion. This type of debt was generally excluded from further rescheduling in both the Paris and London Clubs until 1983. Since then, however, previously rescheduled debt has frequently been rescheduled again for countries facing acute payment difficulties.

## Principal

The provision of economic value by the *creditor*, or the creation of debt liabilities through other means, establishes a principal liability for the debtor, which, until extinguished, may change in value over time. For *debt instruments* alone, for the use of the *principal*, *interest* can, and usually does, accrue on the principal amount, increasing its value.

## **Principal Repayment Schedule**

The repayment schedule of *principal* by due date and installment amount.

## **Private Creditors**

Creditors that are neither governments nor public sector agencies. These include private bondholders, private banks, other private financial institutions, and manufacturers, exporters, and other suppliers of goods that have a financial claim.

#### Provisioning

Funds set aside in an entity's account for potential losses arising from financial claims that are not serviced by the debtor, and/or from claims on the entity arising out of insurance cover and/or guarantees given. In many *export credit agencies*' accounts, provisions are divided into general and specific provisions. General provisions apply to the overall business, while specific provisions are on a case-by-case basis. Banks make provisions.

#### **Public Sector Debt**

Total public sector debt consists of all debt liabilities of resident public sector units to other residents and nonresidents.

## **Public Sector External Debt**

Total public sector external debt consists of all debt liabilities of resident public sector units to nonresidents.

# Q

## **Quantitative (or Cover) Limits**

A ceiling on the amount of insurance or credit that an *export credit agency* will provide under certain circumstances. Limits can apply to individual buyers or to total exposure on buying countries or to maximum contract sizes.

## R

# **Rapid Credit Facility (RCF)**

The RCF is an IMF credit facility that provides rapid financial assistance with limited conditionality to LICs facing an urgent balance of payments need. The RCF streamlines the Fund's emergency assistance for LICs, and can be used flexibly in a wide range of circumstances. Financing under the RCF currently carries a zero interest rate, has a grace period of 5½ years, and a final maturity of 10 years.

#### **Rapid Financial Instrument (RFI)**

The RFI is an IMF lending facility that was introduced to replace and broaden the scope of the earlier emergency assistance policies. The RFI provides rapid financial assistance with limited conditionality to all members facing an urgent balance of payments need. Access under the RFI is subject to an annual limit of 50 percent of quota and a cumulative limit of 100 percent of quota. Emergency loans are subject to the same terms as the FCL, PLL and SBA, with repayment within 3¼–5 years.

#### Recoveries

Repayments made to an *export credit agency* by a borrowing economy after the agency has paid out on claims by exporters or banks.

## Refinancing

See Debt Refinancing.

#### **Reinsurance by Export Credit Agencies**

*Export credit agencies* may reinsure amounts originally insured by a private sector insurer or commercial bank (some large official agencies are also providing reinsurance for smaller official agencies). For example, a private insurer might keep the *commercial risk* of a loan on its own books, but seek reinsurance against specific *political risks*. In addition, some export credit agencies may receive reinsurance from their governments or purchase it in the private reinsurance market.

#### **Remaining (Residual) Maturity**

The period of time until debt payments fall due. In the *Guide*, it is recommended that short-term remaining maturity of outstanding *external debt* be measured by adding the value of outstanding short-term external debt (original maturity) to the value of outstanding long-term external debt (original maturity) due to be paid in one year or less.

#### **Repayment Period**

The period during which the debt obligation is to be repaid.

## Rephasing

A revision of the terms of repayment of a debt obligation.

#### **Reporting Banks**

In *BIS* terminology, all those deposit-taking institutions (plus some non-deposit-taking financial institutions) that submit data to be included in the BIS International Banking Statistics.

#### **Repudiation of Debt**

A unilateral disclaiming of a *debt instrument* obligation by a debtor. It is not recognized as a change in position, and does not affect the gross external debt position.

#### Rescheduling

See Debt Rescheduling.

#### **Rescheduling Agreement**

An agreement between a *creditor*, or a group of creditors, and a *debtor* to reschedule debt. This term is sometimes used loosely to apply to a *debt-reorganization/restructuring* agreement, one element of which is rescheduling.

#### **Rights Accumulation Program**

An IMF program of assistance established in 1990 whereby a member economy with long overdue obligations to the IMF, while still in arrears, may accumulate "rights" toward a future disbursement from the IMF on the basis of a sustained performance under an IMF-monitored adjustment program. Countries incurring arrears to the IMF after end-1989 are not eligible for assistance under this program. Rights Accumulation Programs adhere to the macroeconomic and structural policy standards associated with programs supported by the *Extended Fund Facility* (EFF) and the *Poverty Reduction and Growth Facility* (PRGF), and performance is monitored, and rights accrue, quarterly.

## S

#### **Sector Classification**

In the 2008 SNA and BPM6, institutional sectors are formed by the grouping of similar kinds of institutional units according to their economic objectives and functions.

#### **Short Positions**

Short positions occur when an institutional unit sells securities for which it is not the economic owner. The short position is shown as a negative asset, rather than a liability. (See *BPM6*, paragraph 7.28).

#### Short-Term Commitments or Credits

In the context of *export credits*, short-term commitments are those that provide for repayment within a short period, usually six months (although some *export credit agencies* define short-term credits as those with repayment terms of up to one or two years). Short-term business represents the bulk of that of most export credit agencies and normally includes transactions in raw materials, commodities, and consumer goods.

#### **Short-Term Debt**

Debt that has maturity of one year or less. Maturity can be defined either on an original or remaining basis. (See also *Original Maturity* and *Remaining Maturity*.)

#### **Sovereign Debt**

Sovereign debt is often used by financial markets and fiscal analysts as debt that has been contracted by the national government. Unlike grouping of the public sector, which is based on institutional units, "sovereign" is defined on a functional basis. Normally "sovereign issuer" of debt is the government (usually national or federal) that de facto exercises primary authority over a recognized jurisdiction whose debt are being considered. Consequently, sovereign debt is debt that has been legally contracted by the national government.

#### **Special Accounts**

In the context of the Paris Club, deposits into special accounts were first introduced in 1983 for *debtor countries* that had a history of running into arrears. After signing the *Agreed Minute*, the debtor makes monthly deposits into an earmarked account at the central bank of one of the *creditor countries*. The deposit amounts are roughly equal to the *moratorium interest* that is expected to fall due on the rescheduled debt owed to all Paris Club creditors combined, and any other payments falling due during the *consolidation period*. The *debtor* then draws on the deposited funds to make payments as soon as the bilateral agreements with the individual Paris Club creditors are signed and as other payments fall due.

#### Stand-By Arrangements (SBA)

The bulk of non-concessional IMF assistance is provided through SBAs. The SBA is designed to help countries address short-term balance of payments problems. Program targets are designed to address these problems and disbursements are made conditional on achieving these targets ('conditionality'). The length of a SBA is typically 12–24 months, and repayment is due within 3<sup>1</sup>/<sub>4</sub>-5 years of disbursement. SBAs may be provided on a precautionary basis—where countries choose not to draw upon approved amounts but retain the option to do so if conditions deteriorate—both within the normal access limits and in cases of exceptional access. The SBA provides for flexibility with respect to phasing, with front-loaded access where appropriate.

## **Stand-By Credit**

A commitment to lend up to a specified amount for a specific period, to be used only in a certain contingency.

## Standby Credit Facility (SCF)

The SCF is an IMF concessional lending facility that provides financial assistance to LICs with short-term balance of payments needs. The SCF replaced the High-Access Component of the Exogenous Shocks Facility (ESF), and can be used in a wide range of circumstances, including on a precautionary basis. Financing under the SCF currently carries a zero interest rate, with a grace period of 4 years, and a final maturity of 8 years.

## Standstill

This is an interim agreement between a *debtor economy* and its commercial banking creditors that defers principal repayments of medium- and long-term debt and rolls over short-term obligations, pending agreement on *debt reorganization*. The objective is to give the debtor continuing access to a minimum amount of trade-related financing while negotiations take place and to prevent some banks from abruptly withdrawing their facilities at the expense of others.

## **Stock Figures**

The value of financial assets and liabilities outstanding at a particular point in time.

## **Stock-of-Debt Operation**

In the context of the Paris Club, restructuring of the eligible stock of debt outstanding. These restructuring operations were granted to Egypt and Poland in 1991 and, partially, for Russia and Peru in 1996 and are being implemented for low-income countries under Naples, Lyon, and Cologne terms (see *Concessional Restructuring*), provided that certain conditions are met: the debtor economy has implemented earlier flow rescheduling agreements for at least three years and has an appropriate arrangement with the IMF.

## **Stress Test**

A stress test is a "what if" scenario that takes the world as given but assumes a major change in one or more variables in order to see what effect this would have on various indicators. For instance, for an economy, the impact on growth, inflation, and *external debt* of a huge change in oil prices could be considered. *Stress tests* are particularly useful for financial institutions: for instance, an individual entity might consider the impact on net worth of a sharp movement in financial market prices, in order to help determine the appropriate level of capital to hold.

# Structural Adjustment Facility (SAF)/ Enhanced Structural Adjustment Facility (ESAF)

The SAF was established by the IMF in 1986 and is no longer operational. The ESAF was established by the IMF in 1987 and was made a permanent, rather than a temporary, facility in September 1996. It was renamed the *Poverty Reduction and Growth Facility (PRGF)* in November 1999. (See *Poverty Reduction and Growth Facility (PRGF)*.) The PRGF was replaced by the ECF in January 2010.

#### **Subordination Strategy**

The policy of Paris Club creditors is that loans extended after the *cutoff date* are not subject to rescheduling; therefore, pre-cutoff date loans are effectively subordinated to post-cutoff loans. (See *Cutoff Date*.)

## **Supplier's Credit**

A financing arrangement under which an exporter extends credit to the buyer.

## Т

## **Technical Cooperation Grants**

There are two basic types of technical cooperation:

(1) free-standing technical cooperation (FTC), which is the provision of resources aimed at the transfer of technical and managerial skills or of technology for the purpose of building up general national capacity without reference to the implementation of any specific investment projects; and (2) investment-related technical cooperation (IRTC), which denotes the provision of technical services required for the implementation of specific investment projects.

## **Terms-of-Reference Rescheduling**

Paris Club rescheduling involving only a small number of *creditors*. Typically, this does not require a rescheduling meeting between the *debtor economy* and its creditors, with the agreement being reached through an exchange of letters.

## **Tied-Aid Loans**

Bilateral loans that are linked to purchases of goods and services by the *debtor economy* from the *creditor economy*.

## **Toronto Terms**

See Concessional Restructuring.

## **Total Official Flows (Gross or Net)**

The sum of *official development assistance* (ODA) and *other official flows* (OOF). Represents the total (gross or net) *disbursements* by the official sector of the *creditor economy* to the recipient economy (debtor economy).

## **Trade-related credits**

Trade-related credits is a wider concept that, in addition to trade credit and advances, also captures other credits provided to finance trade activity, including through banks. It is defined

as including trade credit and advances, trade-related bills, and credit provided by third parties to finance trade, such as loans from a foreign financial or export credit institution to the buyer.

#### Tranche

A particular portion of a financial claim or liability with its own specific terms as opposed to the general terms governing the whole claim or liability.

#### **Transfer Clause**

A provision that commits the debtor government to guarantee the immediate and unrestricted transfer of foreign exchange in all cases, provided that the private sector pays the local currency counterpart for servicing its debt.

#### **Transfer Risk**

The risk that a borrower will not be able to convert local currency into foreign exchange, and so be unable to make *debt-service* payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's economy. This is a particular kind of *political risk*.

#### Transfers

Transfers are transactions where there is a transfer of a real resource or a financial item without a quid pro quo.

## U

## Undisbursed

Funds committed by the *creditor* but not yet utilized by the borrower. In BIS terminology, this refers to open lines of credit that are legally binding on lending banks. A transaction in the *balance of payments* or a position in the *international investment position* (IIP) is only recorded when an actual *disbursement* takes place.

#### **Unrecovered Claims**

See Claim Payments.

## **Upper-Middle-Income Countries**

In the context of the Paris Club, countries not considered *lower-middle-income* or *low-income countries*. These countries receive nonconcessional rescheduling terms, originally with flat repayment schedules, but in the 1990s increasingly with graduated payment schedules that have a maturity of up to 15 years and a grace period of 2–3 years for *commercial credits*. Official development assistance credits are rescheduled over 10 years, including a grace period of 5–6 years. The World Bank classifies as upper-middleincome those countries with *GNI* per capita income of between \$3,976 and \$12,275 in 2010. Income classifications are set each year on July 1, and are fixed during the period ending on June 30

of the following year.

#### V

## Vienna Initiative

The European Bank Coordination "Vienna" Initiative (EBCI) was launched in January 2009 to provide a framework for coordinating the crisis management and crisis resolution of financial sector issues in emerging eastern Europe. The European Bank for Reconstruction and Development (EBRD) was a lead founder of the initiative. The Initiative brought together public and private sector stakeholders of EU-based cross-border bank groups present in emerging Europe, including: international financial institutions (International Monetary Fund, the EBRD, European Investment Bank and the World Bank), European institutions (European Commission and the European Central Bank as observer), home and host country regulatory and fiscal authorities of large cross–border bank groups, and the largest banking groups operating in the EBRD region.

#### W

## World Bank Group

Founded in 1944, the World Bank Group (or World Bank) consists of five closely associated institutions: the *International Bank for Reconstruction and Development* (IBRD), the *International Development Association* (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and the International Centre for Settlement of Investment Disputes (ICSID). The World Bank is the world's largest source of development assistance; its main focus is on helping the poorest people and the poorest countries through IDA credits (concessional lending) and on providing IBRD loans to low-and middle-income countries for developmental purposes. To achieve its poverty-reduction mission, the World Bank focuses on investing in people, particularly through basic health and education; protecting the environment; supporting and encouraging private business development; and promoting reforms to create a stable macroeconomic environment and long-term economic growth.

## Write-Off

(See Debt Write-off).

## Y

## **Yield-to-Maturity**

The yield-to-maturity rate is the rate at which the present value of future interest and principal payments—that is, all future cash flows from the bond—equals the price of the bond.

# **Appendix VII. Treatment of Arrears in the Gross External Debt Position**

# Introduction

1. In the 2003 version of the *Guide*, the nonpayment, when due, of principal and/or interest resulted in a reduction in the amount outstanding of the appropriate instrument, such as a loan, and an increase in arrears (a short-term liability that was included under *other debt liabilities*), leaving the external debt position unchanged (see 2003 version of the *Guide*, paragraph 2.29)<sup>1</sup>. In the gross external debt position, the debt was extinguished and a new short-term debt liability was created. In line with *BPM6*, the treatment has changed; when arrears related to the late payment of principal and interest on debt instruments occur, no transactions should be imputed, but the arrears should continue to be shown in the same instrument until the liability is extinguished. Then, arrears are identified as a supplementary category of the original asset or liability, rather than treated as the repayment of the original liability and the creation of a new short-term liability.

2. This appendix summarizes the treatment of arrears in the gross external debt position, the way they are classified and presented, and identifies main changes introduced in the updated *Guide*. In summary (see discussion below), the treatment of arrears in the *Guide* is fully consistent with *BPM6*, and because data on arrears are important in their own right, the *Guide* recommends that detailed data on arrears (similar to that required by the previous version of the *Guide*) continue to be presented, if significant.

3. Arrears are defined as amounts that are past due-for-payment and unpaid. Only the amounts past due are classified as arrears—for example, in the case of overdue installments, only the overdue part is in arrears (see *BPM6*, paragraph 5.99). A liability ceases to be in arrears if all overdue payments are met. Arrears can arise both through the late payment of principal and interest on debt instruments (which are recorded in the original debt instrument) as well as through late payments for nondebt instruments and other transactions (which are recorded in a new debt instrument).

## Arrears on debt instruments

4. Debt service payments may be missed for a variety of reasons beyond simply the inability or unwillingness of the debtor to meet its payment obligations. A failure by a debtor economy to honor its debt obligations (default, unilateral moratorium, etc.) is not debt reorganization because it does not involve an arrangement between the creditor and the debtor (see Chapter 8). Such failure gives rise to arrears.

5. Different types of arrears are identified below. If the amounts of this different type of arrears are significant, it is encouraged that these amounts be separately identified and disseminated by the compiling economy.

• Arrears resulting from inability or unwillingness of the debtor to pay (the most common or frequent type);

<sup>&</sup>lt;sup>1</sup> This treatment of arrears was fully consistent with *BPM5* (see *BPM5*, paragraph 458).

- Sometimes arrears arise not from the ability of the original debtor to provide national currency but from the inability of the monetary authorities to provide foreign exchange to another resident entity, so preventing that entity from servicing its foreign currency debt. These so-called *transfer arrears* remain those of the original debtor sector;
- Another circumstance may be when the creditor has agreed in principle to reschedule debt—that is, reorganize payments that are falling due—but the agreement has yet to be signed and implemented. In the meantime, payments due under the existing agreement are not made, and arrears arise—so-called *technical arrears*. Such arrears might typically arise in the context of Paris Club agreements between the time of the Paris Club rescheduling session and the time when the bilateral agreements are signed and implemented. If the agreement in principle lapses before the agreement is signed, then any accumulated arrears are no longer technical arrears;
- *Involuntary arrears* resulting from developments in the creditor country that prevents the debtor from making payments (for example in cases of war or international economic sanctions against the creditor country)<sup>2</sup>;
- *Validation arrears* resulting from disagreement between the creditor and the debtor on the amounts due;
- *Litigation arrears* resulting from major disputes about the legitimacy of debt liabilities.

6. For arrears arising from a debt contract, interest should accrue at the same interest rate as on the original debt, unless a different interest rate for arrears was stipulated in the original debt contract, in which case this stipulated interest rate should be used. The stipulated rate may include a penalty rate in addition to the interest rate on the original debt. Typically, the first type of arrears and transfer types of arrears can involve penalties, while technical and involuntary arrears may not; penalty rates in validation and litigation arrears would be treated on a case-by-case basis.

7. According to the accrual basis, repayments of debts (both periodic payments and amount to be paid at maturity) are recorded when they are extinguished (such as when they are paid, rescheduled, or forgiven by the creditor). Therefore, when arrears related to the late payment of principal and interest on debt instruments occur, no transactions should be imputed. If interest is not paid when due, the gross debt position will increase by the amount of interest that has accrued during the period and is in arrears at the end of the period. However, if the contract provided for a change in the characteristics of a financial instrument when it goes into arrears, this change should be recorded as a reclassification in the gross external debt position.<sup>3</sup>

8. While a debt instrument that includes arrears might be valued at both nominal and market value, if relevant (this *Guide* recommends that both market and nominal values be provided for debt securities—see paragraph 2.33), when arrears are separately presented (such as in table 4.2) and/or identified as memorandum items to tables, they should be valued at

<sup>&</sup>lt;sup>2</sup> Involuntary arrears may also include cases whereby payments are not made because the creditor does not bill the debtor in a timely manner.

nominal value. This is because it is a measure of the overdue amount that the debtor owes to the creditor, according to the terms of the contract between the two parties.

9. Incurring arrears does not involve a transaction, because it is a unilateral act of one party. Therefore, it is not shown as giving rise to entries in the standard presentation of the financial account of the balance of payments. Nevertheless, arrears related to exceptional financing are recorded as transactions in the analytical presentation of the balance of payments.<sup>4</sup>

# Arrears on nondebt instruments and other transactions

10. Arrears can also arise through late payments for nondebt instruments and other transactions. For instance, a financial derivative contract is not a debt instrument (see Chapter 3) but if it comes to maturity and a payment is required but not made, arrears are created.

11. Consistent with the accrual principle, an overdue obligation to settle a financial derivative contract is not recorded as a transaction in the balance of payments; however, the obligation is reclassified to a debt liability because of the change in the nature of the claim (see *BPM6*, paragraphs 3.56 and 2008 SNA, paragraph 3.175). Once a financial derivative reaches its settlement date, any unpaid overdue amount is classified as *other debt liabilities* in the gross external debt position (in the IIP is reclassified as *other accounts payable-other*), as its value is fixed, and thus the nature of the claim becomes debt (see *BPM6*, paragraph 5.82).

12. Similarly, arrears related to late payments of taxes, purchase and sale of securities, securities lending fees, gold loan fees, wages and salaries, dividends, and social contributions are classified as *other debt liabilities* in the gross external debt position (*other accounts payable—other* in the IIP; see paragraph 3.42 and *BPM6*, paragraph 5.73).

13. Also, if goods and/or services are supplied and not paid for on the contract payment date or a payment for goods and/or services is made but the goods and/or services are not delivered on time, then arrears are created. These new debt liabilities for late payments or late delivery of goods and/or services should be also recorded as *trade credit and advances* in the gross external debt position (see Chapter 3, paragraph 3.43) as well as in the IIP. These arrears are typically nonnegotiable instruments and their primary valuation is nominal value.<sup>5</sup>

14. If an item is purchased on credit and the debtor fails to pay within the period stated at the time the purchase was made, any extra charges incurred should be regarded as interest and accrue until the debt is extinguished (see *BPM6*, paragraph 11.71).

<sup>&</sup>lt;sup>3</sup> This reclassification is recorded in the international accounts in the other changes in the financial assets and liabilities account.

<sup>&</sup>lt;sup>4</sup> This treatment is because, although the accumulation of arrears is not a transaction, it is an action the authorities may take to manage their payments requirements (the analytical presentation of the balance of payment is focused on the actions of the authorities to meet balance of payments needs, and accumulating arrears is an action the authorities can take for this purpose). Exceptional financing and recording of arrears within exceptional financing are discussed in Appendix 1 of *BPM6*.

<sup>&</sup>lt;sup>5</sup> As mentioned in footnote 4 if arrears are traded on secondary markets, as sometimes occurs, then a separate market value could be established.

#### Presentation of Data on Arrears

15. In macroeconomic statistics, arrears should continue to be shown in the same instrument<sup>6</sup> until the liability is extinguished, and they are not separately identified as a debt instrument. Information on arrears is useful for various kinds of policy analyses and solvency assessments and should supplement the debt statistics where significant. Compilers will need to collect and disseminate information on debt-service payments in arrears because this information is no longer presented separately in an accrual basis of recording system. Information on arrears should continue to be collected from their creation—that is, when payments are not made—until they are extinguished, such as when they are repaid, rescheduled, or forgiven by the creditor.

16. The *Guide* recommends that total value of arrears by sector be separately identified in memorandum items to Table 4.1 (arrears are recorded in the original instrument until the liability is extinguished and are presented in nominal value in the memorandum items). Such information is of particular analytical interest to those involved in external debt analysis, since the existence of arrears indicates the extent to which an economy has been unable to meet its external obligations. This information on arrears is essentially the same as that one contained in the body of table 4.1 of the 2003 version of the *Guide*. Similarly, total value of arrears by sector is separately identified in memorandum items to Table 5.1 that presents the gross external debt position on the basis of a public-sector-based approach.

17. The 2003 version of the *Guide* encouraged a further disaggregation of arrears into arrears of principal and of interest in the gross external debt position table, for economies in which arrears are very significant (see 2003 version of the *Guide*, paragraph 4.5). The new version of the *Guide* introduces a new memorandum table, Table 4.2, which presents arrears at nominal value by sector and disaggregated into arrears of principal and interest.

18. The value of arrears is also separately identified in memorandum items to Tables 7.1 (Gross External Debt Position: Short-Term Remaining Maturity—Total Economy) and 7.2 (Gross External Debt Position: Short-Term Remaining Maturity—By Sector) in Chapter 7.

19. The treatment of arrears in the *Guide* is fully consistent with *BPM6*. In both, the gross external debt position and the IIP, arrears on debt instruments are recorded under the appropriate debt instrument, while arrears on nondebt instruments and other transactions are recorded as new debt liabilities within the appropriate instrument, that is, either *trade credit and advances* or *other debt liabilities* in the gross external debt position—see paragraphs 11-13 above—and either *trade credit and advances* or *other accounts payable-other* in the IIP.

<sup>&</sup>lt;sup>6</sup> As mentioned above, a new debt instrument is created when arrears arise through late payments for nondebt instruments and other transactions.

#### Box A7.1 Arrears by Sector

The new version of the *Guide* introduces a new memorandum table, Table 4.2, which presents arrears at nominal value by sector and disaggregated into arrears of principal and interest. The first level of disaggregation is by institutional sector. The primary disaggregation is by the four sectors of the compiling economy described in Chapter 3—*general government, central bank, deposit-taking corporations, except the central bank,* and *other sectors.* A disaggregation of the other sectors into *other financial corporations,* and *nonfinancial corporations, households, and nonprofit institutions serving households* is provided. *Intercompany lending* between entities in a direct investment relationship is separately presented. The second level of disaggregation is by principal and interest (interest includesaccrued interest on arrears of principal and interest

Table 4.2. Gross External Debt Position: Arrears by Sector 1/2/	
	End Period
General Government	
Principal	
Interest	
Central Bank	
Principal	
Interest	
Deposit-Taking Corporations, except the Central Bank	
Principal	
Interest	
Other Sectors	
Principal	
Interest	
Other financial corporations	
Principal	
Interest	
Nonfinancial corporations	
Principal	
Interest	
Households and nonprofit institutions serving households (NPISHs)	
Principal	
Interest	
Direct Investment: Intercompany Lending	
Principal	
Interest	
Debt liabilities of direct investment enterprises to direct investors	
Principal	
Interest	
Debt liabilities of direct investors to direct investment enterprises	
Principal	
Interest	
Debt liabilities between fellow enterprises	
Principal	
Interest	
Total Economy	
1/ Valued at nominal value.	
2/ Interest includes accrued interest on arrears of principal and interest.	