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COLLATERALIZED TRANSACTIONS: KEY CONSIDERATIONS FOR PUBLIC LENDERS AND BORROWERS

EXECUTIVE SUMMARY

In a response to a request from the G20 IFA Working Group, this note provides a framework for public lenders and borrowers to assess collateralized financing practices from a development perspective. It describes the main dimensions of collateralized debt instruments. Starting from the observation that collateralization may permit market access and transactions that otherwise would not occur, it then discusses the broader pros and cons of such arrangements, as well as technical and macroeconomic considerations that arise in their design. It concludes by describing a decision process for public lenders and borrowers (general government entities, state enterprises, and agencies that act on their behalf) to ensure that collateralized transactions are consistent with the G20's Operational Guidelines for Sustainable Financing.¹

The work of the IMF and World Bank suggests that the availability of collateralized financing can be beneficial to a developing country borrower under a range of circumstances, but also points to pitfalls. Whether or not the benefits of collateralized financing outweigh its drawbacks requires a case-by-case assessment. Inter alia, this will depend on the institutions and legal processes of the borrowing country. In general, from a development perspective:

- **Collateralized finance is more likely to lead to beneficial outcomes if:** (i) the transaction produces assets or revenue streams that can be used for repayment (as opposed to financing consumption or the general fiscal deficit); (ii) the reduced risk resulting from collateralization is reflected in improved financial terms; (iii) a rigorous debt sustainability assessment is passed; (iv) there is full, public transparency on all contractual terms; and (v) collateralization respects and complies with any applicable Negative Pledge Clauses (NPCs). Transparent non-recourse project finance can generally meet these tests.
- **Collateralized financing could be harmful in two key circumstances.** Foremost, when a transaction does not produce an asset or revenue stream that can

¹See [Assessing Public Sector Borrowing Collateralized on Future Flow Receivables](#), (IMF 2003), for a more detailed analysis of this type of financial instrument, including further examples of actual transactions, empirical analysis, and full articulation of economic and technical considerations.

be used for repayment, and the volume of the transaction raises broader financing or debt distress concerns. Second, when the transaction does not involve adequate transparency and disclosure (and would thus impede the ability of future creditors to correctly assess risks and lend sustainably, contributing to future problems).

This note represents a contribution to the IMF and World Bank’s Multi-Pronged Approach (MPA) to address debt vulnerabilities. The MPA includes pillars on transparency, capacity building, analytical tools, and IFI policies for sustainable lending. The discussion of collateralized transactions is meant to encourage greater transparency and provide guidance to both creditors and borrowers (building their capacity to analyze such transactions). It will also inform the policy pillar of the MPA, in particular the reviews of the the IMF’s Debt Limits Policy (DLP) and World Bank’s Sustainable Development Financing Policy (SDFP), and guidance on how to assess and handle collateralized loans and existing lending exposures.

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INTRODUCTION

1. A debt instrument is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. In a legal sense, it entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. More broadly, and for the purposes of this note, it also includes arrangements that do not constitute granting of a security interest, but that have an equivalent effect. Future receivables can cover many different items from oil revenues to lottery ticket sales. Any asset which can be identified, isolated, attributed a value or provides a predictable cash flow can serve as the basis for collateralized financing. Acceptable collateral has included: cash; stocks and negotiable bonds; irrevocable letters of credit; certificates of deposit; assignment of receivables such as export earnings, electricity generation charges, road tolls, and telecom receipts; as well as physical assets such as buildings, ports, and industrial plants.

2. Collateralization is standard practice for many types of private-sector financing. The use of collateral is widespread in the private sector. It is sought by creditors to help mitigate perceived risks posed by the borrower or by the nature of the transaction. Financial institutions extensively require collateral in lending, in securities trading and derivatives markets and in payment and settlement systems. For international trade finance, the most easily available collateral is the traded good itself.

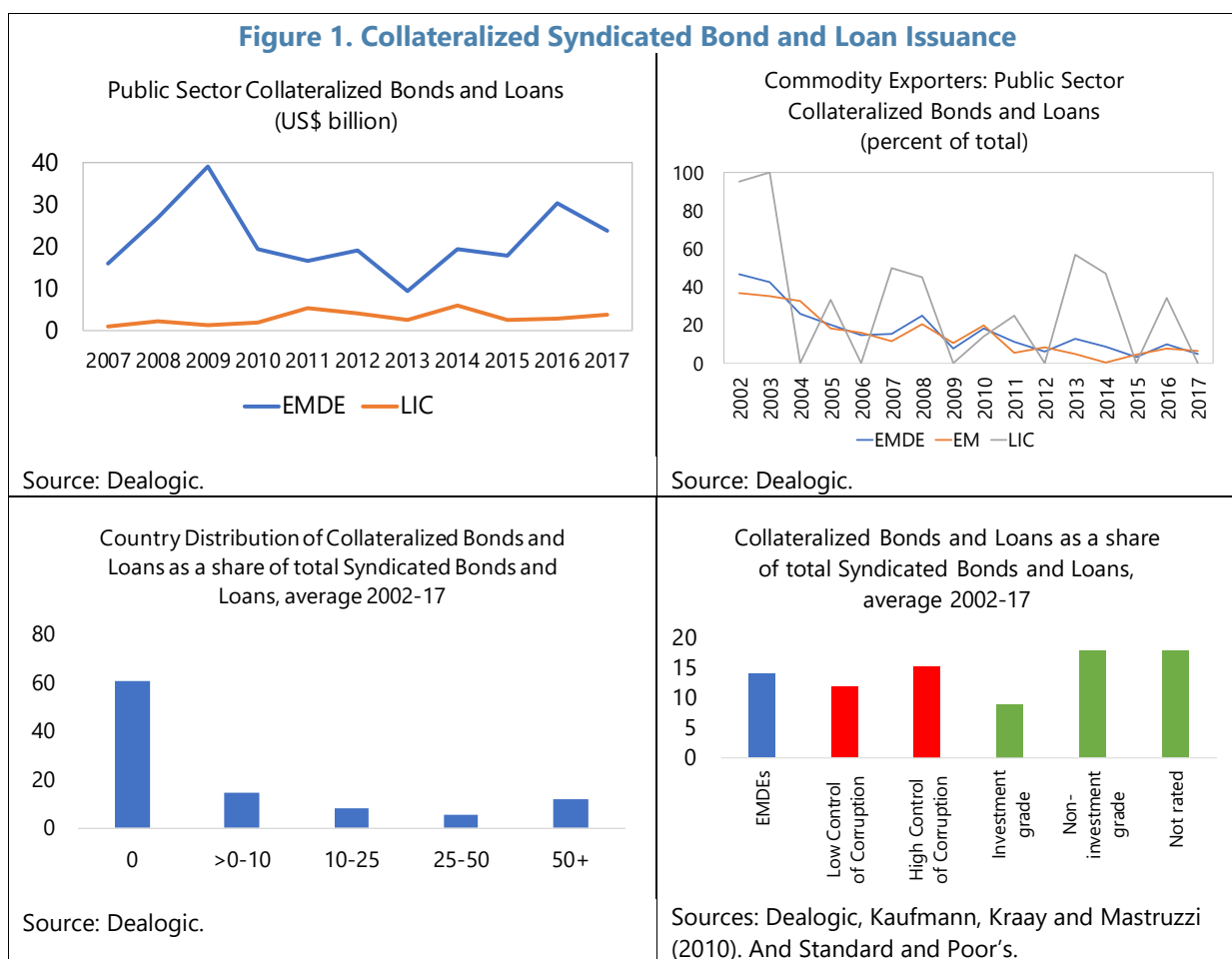
3. Governments and sub-sovereigns also make use of collateral. The use of collateral is widespread for certain types of project financing, e.g., oil exploration. Governments may also request collateral from beneficiaries when offering sovereign guarantees. Collateral has also been used to facilitate and support debt restructuring (e.g., Brady bonds). Finally, central banks generally require collateral for their credit operations.

4. There are concerns that collateralized public debt has risen in recent years, but accurate measures are limited. Data from Dealogic (Figure 1), which captures syndicated sovereign commercial borrowing and bonds but excludes collateralized lending by export credit agencies, suggests a slight increase in collateralized lending since 2007, starting from a relatively low level. Reliance on collateralized syndicated bonds and loans is concentrated in a few countries: most borrowers do not use collateralized syndicated debt finance at all, while the share of collateralized syndicated finance in total syndicated finance exceeds 25 percent in 20 percent of countries and 50 percent in about 10 percent of countries. Some analysts are of the view that many recent official bilateral infrastructure loans to sub-Saharan Africa are collateralized (Brautigam and Hwang 2018).²

5. Collateralization by public sector borrowers tends to be higher in times of stress, or in lending to countries with a risky borrower profile (e.g., due to their high debt or inherent

²See IMF-World Bank (2020) *The Evolution of Public Debt Vulnerabilities in Low Income Economies* for more details on what is known about collateralized official lending.

volatility). The use of collateralization is higher among non-investment grade and non-rated countries than among investment grade countries. Poor control of corruption is not associated with higher usage, however, perhaps reflecting a less effective enforcement technology or sample bias. Of course, a country must have assets or revenue streams that are usable for the purpose. Low-income countries classified as commodity producers (and their resource-producing state enterprises) tend to fit these qualifications and therefore tend to use collateralized debt instruments heavily at times (Figure 1).³



6. This note articulates a framework for public lenders and borrowers to assess the development impact of collateralized financing (based on earlier World Bank and IMF work).

The note describes how public sector lenders and borrowers (general government entities, state enterprises, and agencies that act on their behalf) can consider and minimize the possibility of unintended consequences. Section I classifies the different types of collateralized debt instruments along several dimensions. Section II discusses the pros and cons, drilling down to the various technical and macroeconomic considerations that arise. Section III concludes by laying out the

³Not every kind of commodity is useful for collateralization. The value of commodity collateral is determined by: (i) the quality of the commodity; (ii) the transparency of the market; (iii) liquidation costs; (iv) the price volatility of the commodity; (v) the durability of the commodity; and (vi) the location of the commodity.

needed institutions and legal framework in borrowers, and a decision process for public lenders and borrowers to determine whether to engage in collateralized transactions.

CLASSIFICATION

7. Collateralized transactions can be highly complex and tailored but have several dimensions that can be used to help classify them:

- **The economic nature of the collateral.** Collateral may be in the form of: (i) an existing or future asset (stock); or (ii) a future flow or stream. In the latter case (also called future receipts or future receivables) these could be defined as a financial amount (e.g., US\$) or a physical amount of goods to be delivered (e.g., barrels of crude oil).
- **The relationship between the collateral and the original transaction.** The collateral can be related or unrelated to the transaction. Collateralized debt is considered to have related collateral if the financing is used to purchase or construct a new asset (e.g., an airplane, an oil platform), and the asset or the future receipts it is expected to generate (e.g., airline ticket sales, or the revenues from the sale of oil) serve as collateral to secure the debt. An example for an unrelated collateralization is a budget loan collateralized with oil receivables.
- **Whether the borrowing is done directly (on balance sheet), or indirectly (off balance sheet).** Direct collateralized arrangements involve the pledge by a government or public enterprise of specified assets or receipts as collateral for debt incurred by the government or public enterprise. In an indirect collateralized arrangement, the collateral is generally assigned to a special purpose vehicle (SPV) which then grants it (or shares in the SPV) to the creditors as collateral. Future receivables are no longer treated as assets of the government or public enterprise (assuming that the SPV is a separate and fully independent entity). Consequently, the holders of the securities issued by the SPV have no claim against, or other relationship with, the government or public enterprise.⁴
- **Whether the collateralized debt instrument is marketable or non-marketable.** Marketable collateralized debt instruments are securities that can be traded on the secondary market. They tend to be subject to stricter oversight arrangements and are more likely to generate better borrowing terms and conditions than non-marketable, and hence illiquid, collateralized debt instruments. They can be restructured like non-marketable collateralized instruments although in some instances their diffuse ownership can create a

⁴SPV arrangements should be assessed on a case-by-case basis. It is possible that underlying legal documentation may grant investors claims on government resources in the event of default, notwithstanding the assignment of collateral to the SPV. Moreover, a determination should be made, based on the IMF's *Government Financial Statistics Manual* (GFSM) 2014, about whether the SPV is truly an independent entity or if it should be classified as part of the general government.

complication. Examples of marketable instruments used in collateralization include notes, commercial papers, and bonds.

8. The majority of collateralized transactions can be grouped into broad categories based on these dimensions. Table 1 contains illustrative examples of collateralized transactions.⁵

Collateralized trade financing is generally non-marketable, indirect and uses related collateral. Collateralized project financing is also generally non-marketable and indirect, however both related and unrelated collateral can be deployed. In some cases, such as IBRD's Enclave Loans,⁶ limited or non-recourse projects, or pre-export financing arrangements, related collateral tends to be used. Yet, there are instances where project financing is backed by unrelated collateral, which often takes the form of receivables from commodity exports.

9. There are other types of secured transactions that can arise in the context of debt management. Several governments have engaged in sovereign borrowing in a form similar to repurchase agreements ("repos"). A repo agreement involves the sale of securities for cash, at a specific price, with a commitment to repurchase the same or similar securities at a fixed price either on a specified future date or with an open maturity. Other securities—with potentially a much larger face value—are provided as collateral. The economic nature of the transaction is the same as that of collateralized loan because the risks and rewards of ownership of the securities remain with the original owner (security provider)

⁵For simplicity, the Table sets aside the economic nature of the collateral and direct versus indirect approaches, since these can apply in both ways in all cases.

⁶<http://pubdocs.worldbank.org/en/642691552422713192/IBRD-Enclave-Loans-for-IDA-Countries-FINAL-3-12-2019.pdf>

Table 1. Examples of Collateral Transactions, Categorized

	Related	Unrelated
Non-Marketable	<p>A government or an SOE receives a loan to finance the purchase of an asset (e.g., an oil platform or a tanker). Either the new asset or the expected future revenues serve as collateral.</p> <p>Examples:</p> <ul style="list-style-type: none"> • An Export Credit Agency lends to the government of another country to finance the purchase of a power generator, and either that power generator or the electricity revenues it is expected to generate will serve as collateral. • Trade finance. 	<p>A government gets a loan to finance government expenditures, collateralized on the receivables from future revenues of an SOE through an irrevocable receivable's security assignment deed and/or through a lien on minimum balances in a debt service reserve account held abroad. Typically, a commodity or commodity-related receivables are used (e.g., oil, gold, bauxite, others).</p> <p>Examples:</p> <ul style="list-style-type: none"> • Oil receivables. Credit lines to a sovereign collateralized on oil receivables, the proceeds of which are used to finance general government expenditure. • Oil prepayment. Loan to a sovereign from a commodity trader, which is either prepaid in, or collateralized on, a physical amount of oil to be delivered to a designated off-taker. • Fishing rights. In some small states loans have been collateralized by fishing rights, with the proceeds used to finance general government expenditure. • Commodity barter schemes. A sovereign obtains a loan collateralized on the future expected commodity exports and possibly the resource itself, with the repayment set in terms of a physical amount of the commodity to be delivered. The proceeds of the loan are used to finance general government expenditure.
Marketable	<p>A government issues bonds where principal and interest payments are secured by revenues (e.g., charges or rents) paid by the users of the facility financed with the proceeds of the bond issuance.</p> <p>Example:</p> <ul style="list-style-type: none"> • Revenue bonds of U.S municipalities to finance infrastructure projects. 	<p>A government issues marketable securities which are collateralized with some asset or revenue stream, with the proceeds of the security used to finance current expenditures. The type of assets typically used are government owned buildings and other infrastructure, while the typical streams are future tax revenues or non-tax revenues from fees, tariffs, etc.</p> <p>Examples:</p> <ul style="list-style-type: none"> • A sub-sovereign state issued marketable securities in 2014 collateralized on future oil and gas revenues, the proceeds of which were used to fund the state pension fund. • A sovereign country's issuance in 2001 of debt through an SPV collateralized on future receivables generated by two national lotteries, the proceeds of which were used to finance general government expenditure. The government did not guarantee the debt.

ASSESSMENT

10. Collateralized transactions can have pros and cons for both lenders and borrowers:

- For **lenders**, collateral can increase the security of repayment and reduce the need to monitor the borrower (and the associated costs). Of course, the value of the collateral depends on how easily it can be enforced, but collateralization can in principle allow lending in risky situations that would not otherwise be financed. However:
 - While the creditor whose loan is secured may benefit, *other* creditors are legally or de facto subordinated as collateralized creditors have a prior claim on resources that the government could otherwise have used towards meeting the claims of unsecured creditors. The creation of a senior class of debt increases the likelihood that unsecured creditors only will bear the full cost of the debtor incurring arrears, default, or undertaking a debt restructuring.
 - In the event that the borrower does not properly disclose the existence of collateral, even *future* lenders can be affected, since the level of outstanding senior debt affects the pricing of unsecured debt.
 - If collateral is difficult to enforce, it is no longer obvious what creditors can expect to recover. In such a setting, the presence of collateral could induce additional frictions on how to share the burden of a restructuring across creditors but in this instance burden sharing arrangements can become a source of friction across creditors.
 - Finally, a lender also needs to internalize that potential negative side effects for the borrower (next bullet), could undermine a longer-term development relationship.
- For **borrowers**, collateral can increase market access, reduce borrowing costs, or both. However, it can also have negative impacts:
 - The presence of collateral can raise the risk of debt distress through multiple channels: (i) by reducing budget flexibility (through the earmarking resources); (ii) in the absence of strong debt management, by making it easier to overborrow; and (iii) by impairing access to non-secured financing, particularly after bad shocks. These problems can arise even when collateralized borrowing is fully transparent.
 - The presence of collateral can complicate a debt restructuring, including by increasing the probability of arrears to unsecured creditors. The possibility of restructuring debt is an implicit way in which borrowers and lenders share risk (for example, in response to a decline in commodity prices which reduces the borrower's ability to pay). The greater the extent of collateralization, the greater the share of risk born by the borrower (as well as unsecured creditors).

- Improper disclosure exacerbates these problems, including by leading to problems with other lenders (e.g., in connection with NPCs, unmet information undertakings and permitted lien provisions). It can also lead to additional risk premia on non-secured loans.
- Complex collateralization structures can both raise costs and contribute to transparency problems.

11. Whether or not the net impact of collateralized borrowing is beneficial or damaging from a development perspective depends on a number of considerations. As a transaction is considered, lenders and borrowers need to evaluate a range of design issues, including: how it may affect incentives, enforceability, transparency (and complexity), and ensuring improved terms. They also need to evaluate its implications for a country's macroeconomic framework and financing strategy. This starts with expected project returns (which may justify the collateral), but extends to impact on market access, and impact on the risk of debt distress.

A. Design Issues

- **Incentives.** Both public lenders and borrowers need to be alert to the negative incentives that such transactions can create for each other, and work to avoid these. A lender needs to consider whether the use of collateral may be contributing to overborrowing (which can affect overall creditworthiness). The lender also needs to be aware that the use of related collateral, while generally desirable, may give the borrower weaker incentives to make a project succeed than unrelated collateral. A borrower needs to internalize the fact that the weaker the link between project revenues and the revenues that serve as collateral, the higher the incentive for the lender to over-collateralize and the lower the lender's incentives to monitor the economic rate of return of the financed project.
- **Enforceability of collateral.** For a public lender, collateral is of little benefit and cannot motivate improved terms and conditions unless it is enforceable. A borrower must weigh the benefit of improved borrowing terms against the potential loss of collateral, which in some cases could have a significant political impact on the government and society. Enforceability depends on the type of collateral and the governing law of the jurisdiction in which it is located. Generally speaking, large escrow accounts in the lender's jurisdiction are the most readily enforceable (but typically cover only a small portion of the loan), followed by assets which are located outside the borrowers' jurisdiction (e.g., equity shares in a company). Movable assets (e.g., oil cargoes) can also be subject to enforcement actions. Assets within the borrower's jurisdiction are typically harder to enforce.
- **Transparency.** It is vital for all collateralized transactions to be properly disclosed to help public lenders and borrowers achieve sustainable financing practices, and to prevent corruption (e.g., the effective "privatization" of assets on highly advantageous terms to the lender). Reporting arrangements are critical and are a key responsibility of the borrower. For SOEs that use collateralized borrowing, appropriate reporting regimes to government debt

management authorities need to be in place. Lenders also have a responsibility to promote disclosure;⁷ commercial interest may argue for some precise details to be preserved as confidential and kept out of the public domain, but all lenders have a collective interest to ensure that a minimum set of information is made available including asset, amount, nature of security.

- **Complexity.** Public lenders and borrowers should avoid complex forms of collateralized lending. Greater complexity makes it more difficult to assess all-in costs, especially in countries where capacity is weak. It can also translate into higher transaction costs and legal risks. Complexity can also contribute to non-transparency and corruption. Of course, collateralized agreements do involve complex elements, often consist of different related agreements, and may involve additional costs such as export credit premia, remuneration of financial intermediaries, legal fees, and non-monetary “costs”, such as lender step-in rights, and other lender controls over the management and disposal of the secured asset. Adding to this complex base with other features or complications—for instance, loans combining infrastructure development with resource collateral *and* repayment in resources to-be-developed—is thus highly undesirable.
- **Better terms/value.** The granting of collateral should be reflected in better terms and conditions for the borrower, reflecting the lower risk of non-collection on the loan. A public borrower must judge whether the transaction as a whole provides value (and fits within its overall debt management strategy), a calculation that is especially difficult when the collateral is partially enforceable, when there is over-collateralization, or when there are potentially alternative sources of finance available. A public lender can help by providing a quote both with and without collateral while the borrower can seek information from other countries’ transactions in similar circumstances.

12. Evaluating macroeconomic and financing implications

- **Project returns.** These need to be carefully assessed, with project viability evaluated under a reasonable range of possible assumptions about driving factors. If a project results in a new asset which generates a new and sufficiently large flow of revenues, a country’s capacity to repay the loan and other creditors should in principal not be impaired by using the asset or flow of revenues as collateral.
- **Impact on other creditors and future financing.** Lenders and particularly borrowers need to look beyond the specific transaction to understand its broader impact. Collateralization can enable borrowers to bridge times of financial distress, which is in the interest of both the borrower and existing creditors. However, when the borrowing is sizeable enough—which is case-specific—it can impair the value of existing unsecured loans and reduce access to more conventional unsecured funding and/or increase its cost (i.e., due to an overhang of senior

⁷Lender disclosure can play an important role in overcoming agency problems at a borrower level, including due to corruption. but not all are obliged to report (e.g., privately-held commodity traders).

debt). This impact can be increased to the extent that other existing lenders have negative pledge or similar clauses (e.g., permitted lien clauses) and receive security from borrowers pursuant to the clause or in order to cure a breach of the clause, and more broadly to the extent that it damages the borrowers' reputation with capital markets.⁸

- **Impact on the risk of debt distress.** Sustainable lending requires both lenders and borrowers to carefully evaluate debt distress risks. This begins with an assessment of how the transaction could enhance the borrowers' repayment capacity. In general, transactions involving the creation of (related) assets or revenue streams will help to this end. However, significant and sustained collateralized borrowing, using collateral unrelated to the original transaction, tends to raise the risk of a liquidity crisis, because it increasingly subordinates unsecured creditors and depletes the stock of collateral that could be used for additional collateralized lending. The way the transaction is set up matters. Requiring physical units of a commodity as collateral for fixed dollar payments can require all physical production of the commodity to be diverted to lenders when there are large shocks (which leaves little left for other creditors, subverting market access). Risks associated with fluctuation in market prices will be borne solely by the debtor. In contrast fixing repayment in terms of physical commodity units would shift these risks to the lender, while still protecting the lender against other risks that may induce sovereign debt distress.

CONSIDERATIONS FOR SECURING BENEFICIAL DEVELOPMENT OUTCOMES

13. The above discussion suggests that collateralized financing can be beneficial under a range of circumstances. Whether these circumstances are satisfied requires a case-by-case assessment. Borrowing countries need to work to establish the institutions and legal processes to support the effective assessment and execution of collateralized borrowing transactions.

14. In general, from a development perspective, a collateralized transaction is more likely to lead to beneficial development outcomes if: (i) it produces assets or revenue streams that can be used for repayment (i.e. "related assets/revenues"); (ii) the reduced risk resulting from collateralization is reflected in improved financial terms; (iii) a rigorous debt sustainability assessment is passed; and (iv) there is full, public transparency on all contractual terms; (v) collateralization respects and complies with any applicable Negative Pledge Clauses (NPCs), .

15. The discussion also suggests that there are certain types of collateralized transactions which lend themselves to more beneficial development outcomes, and certain types that are more likely to be problematic:

⁸A negative pledge clause is a covenant that limits a borrower's ability to pledge assets to other lenders. The covenant would typically define the scope of indebtedness covered and types of collateral as well as any remedies available to the affected lender in the event it was breached.

- Project-finance related collateralization can generally be designed to be beneficial. With careful project design as a starting point (to ensure viability and efficient use of resources), those designing the transaction can build in full disclosure, fair value, and simplicity in a fairly straightforward way.
- Collateralization involving unrelated assets or revenues, when undertaken on a large scale to finance government consumption, is likely to be problematic. Large scale transactions of this sort increase the risk of a liquidity crisis, are challenging to reverse, and create debt resolution complications. And that is the case *even if* technical design issues are handled well.

In between the two extremes, there are a host of other transaction types which could be either beneficial or harmful for development, depending on design.

16. To support beneficial outcomes, all borrowing countries should work to establish a sound institutional and legal framework to help manage and mitigate risks.

- On institutions, borrowers need to set up internal and external arrangements that ensure proper transaction development and execution. Relevant government agencies that generate and process financing on the borrower side should ensure they have in place procedures that aim at: (i) proper review of the contractual terms to ensure that they comply with the domestic legislation and existing obligations; (ii) matching up the commercial arrangements with the legal details and the post-financial-closing implementation of transaction covenants and requirements; (iii) limiting the prospect of corruption and self-dealing; (iv) enhancing transparency and accountability; (v) ensuring consistency of each transaction with a borrower's overall debt strategy and the country's macroeconomic framework; and (vi) ensuring that supervisory and back-office units have timely and unfettered review and input on transactions in real-time.
- Concerning the legal framework, borrowers should establish the following (among other elements): (i) the nature of assets or future revenues that can be used as security and the nature of projects that can be financed through collateralized debt (and the profitability conditions to be set); (ii) the procedures that need to be followed for the transfer of receivables; and the notice that needs to be given to the lender that the debt is being repaid and the consequences of not giving those notices; (iii) the responsibilities and obligations of the entity in charge of the management of the commodity—being the secured asset—to the central government; and (iv) the requirements for information disclosure.

17. This needs to be complemented by strong government capacity in relevant areas.

Capacity helps guard against over-reliance by a sovereign borrower on external advice and action when executing transactions—in recognition that external advisors cannot fully replace insufficient borrower technical capacity and resources. Critical capacity areas include legal, debt management, fiscal risk management (and debt sustainability analysis), and public investment management. Technical assistance from IFIs can help fill gaps and build capacity over time.

18. Countries without strong institutions and capacity need to be particularly careful when making assessments and making decisions about collateralized transactions. They should generally be cautious about higher volumes and complex forms of such transactions. For all countries appropriate decision-making procedures in any event need to be in place.

DECISION MAKING

19. To promote better development outcomes, both public lenders and borrowers should undertake a careful assessment when considering collateralization (Figure 1).⁹ For lenders, this would align decisions about collateralized transactions with existing G20 Operational Guidelines on Sustainable Financing. For both lenders and borrowers this would ensure that sovereign borrowers and public lenders work together to ensure that financing needs are met while maintaining debt sustainability. The suggested steps in the vetting process are the following: (i) a careful assessment of how sustainability might be impacted (including stress tests covering how much budget and financing flexibility would be retained in shock scenarios); (ii) a check that the proposed terms and conditions account fairly for the value of the security given, and the amount of financing reflects the value of the project; (iii) a check that the legal and technical dimensions of the proposed structure are fully understood by the parties; and (iv) a careful assessment of how the granting of collateral might impact other financing, in the context of the country's debt management strategy (recognizing also that existing negative pledge clauses of other lenders are complied with). Finally, and consistent with G-20 principles, both lenders and borrowers have a responsibility to ensure proper disclosure.

20. When a lender and a borrower cannot successfully complete a due diligence of this form, they should consider other options. These could include renegotiating the terms and conditions of the loan and/or the collateral (e.g., including greater elements of risk-sharing in the financing); or not proceeding with collateralizing the transaction.

21. A borrower may also decide to reverse the decision of collateralization and should therefore have an exit strategy to extricate themselves or may find itself in need of debt restructuring. In this context, the following considerations are relevant:

- **Exit strategies.** Countries that retain access to alternative sources of funding at comparable costs can pre-pay collateralized loans by issuing unsecured debt. Countries could also seek voluntary re-negotiation with creditors by offering alternative credit enhancement techniques, such as guarantees.
- **Debt resolution complications.** Collateral can raise the time and cost of a debt crisis resolution. Even partially secured creditors (i.e., where the collateral may not be easily enforced) retain more leverage, and burden sharing considerations may draw out debt restructuring negotiations, which in turn may delay financing from IFIs. It is important for

⁹Note that this just looks at the decision on collateral. Lenders and borrowers should already have completed a more thorough due diligence.

lenders and borrowers to recognize that delays in completing restructurings create macroeconomic drag, which is beneficial neither for the borrower nor for creditors as a whole. Borrowers need to understand from their legal advisors the potential implication of the collateral that they are taking on, and in the event of a resolution situation, their options. Both lenders and borrowers need to be pragmatic in the event of a resolution situation involving collateral that is not perfectly enforceable, and seek ways to coordinate, including through established fora, with a view to achieve a timely outcome.

