Appendices

Appendix I. Specific Financial Instruments and Transactions: Classifications

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

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

A

American Depository Receipt (ADR)

An ADR is a negotiable certificate that represents ownership of the securities of a non-U.S. resident company. Although the securities underlying ADRs can be debt or money market instruments, the large majority are equities. An ADR allows a non-U.S. resident company to introduce its equity into the U.S. market in a form more readily acceptable to U.S. 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*.

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

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 *long-term, bonds and notes* (*debt securities, portfolio investment* 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 item, *equity liabilities*.

Arrears

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

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

Classification

Arrears of principal and/or interest are reported as new short-term liabilities. If owned by nonresidents, these new instruments are to be included in the gross external debt position as *arrears*. Regarding the original borrowing, the debt outstanding is to be reported as though the principal and interest were paid on schedule.

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, automobile loans—in effect, converting illiquid assets into tradable securities. 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 purchase 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*, *bonds and notes (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 *money market instruments*. 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. So, 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 *banks, short-term, currency and deposits,* or *loans* (*other investment* in the IIP*)* depending on the nature of the account.

Bank Deposits

Bank deposits are claims on banks that are either transferable or are "other deposits." Transferable deposits consist of 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 represented by evidence of deposit—for example, savings and fixed-term deposits; sight deposits that permit immediate cash withdrawals but not direct third-party transfers; and shares that are legally (or practically) redeemable on demand or on short notice in savings and loan associations, credit unions, building societies, etc.

Classification

Bank deposits are liabilities of banks and other depository institutions, and if owned by a nonresident are to be included in the gross external debt position. They should be classified as *banks, short-term, currency and deposits (other investment* in the IIP) unless detailed information is available to make the short-term/long-term attribution.

Banker's Acceptances

A negotiable order to pay a specified amount of money on a future date, drawn on and guaranteed by a bank. 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 bank 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 behalf of the accepting bank; the bank has a claim on the drawer, who is obliged to pay the bank the face value on or before the maturity date. By writing the word "accepted" on the face of the draft the bank carries primary obligation, guaranteeing payment to the owner of the acceptance. Banker's acceptances can be discounted in the sec-

ondary market, the discount reflecting the time to maturity and credit quality of the guaranteeing bank. Since the banker's acceptance carries a banker's obligation to pay (in effect "two-name paper") and is negotiable, it becomes an attractive asset. Banker's acceptances are always sold at a discount and have maturities of up to 270 days.

Classification

Banker's acceptances are money market instruments that are claims on the accepting bank, with the bank owning a claim on the issuer of the bill. As recommended in the *1993 SNA*, flexibility in the application of this recommendation is required to take national practices and variations in the nature of these instruments into account.

If owned by nonresidents, banker's acceptances should be included in the gross external debt position. They should be classified as *short-term, money market instruments (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 *bonds and notes*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *direct investment, intercompany lending* (see the description of *direct investment* in Chapter 3).

Bearer Depository Receipt (BDR)

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

Classification

A BDR is classified according to the nature of the underlying instrument backing it. This is because the "issuing" intermediary does not take the underlying security onto its balance sheet but simply acts as a facilitator. So, the debtor is the issuer of the underlying security. If owned by nonresidents, these instruments are to be included in the gross external debt position. They should be classified as *long-term, bonds and notes* (*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 *money market instruments*. 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 and Notes

Bonds and notes are debt securities with an original maturity of over one year. They are usually traded (or tradable) in organized and other financial markets. Bonds and notes usually give the holder the unconditional right to fixed money income or contractually determined variable money income. With the exception of perpetual bonds, bonds and notes also provide the holder with an unconditional right to a fixed sum as repayment of principal on a specified date or dates.

Classification

Bonds and notes owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, bonds and notes* (*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).

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, bonds and notes* (*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 *money market instruments*. 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, bonds and notes (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 *money market instruments*. 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 tradable 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, bonds and notes (portfolio investment, debt securities* in the IIP). When a Brady bond is issued, the original loan is assumed to have been redeemed unless the terms of the issue of the Brady bond state otherwise. Any debt reduction in nominal value terms should be recorded—see Chapter 8. The initial purchase of the principal collateral (U.S. Treasury bonds) is a separate transaction and is classified as debt of the United States.

C

Certificate of Deposit (CD)

A certificate issued by a bank acknowledging a deposit in that bank 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). 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, money market instruments (portfolio investment, debt securities in the IIP), while those with an original maturity of over one year should be classified as *bonds and notes*. A small minority of CDs are known to be nonnegotiable—not tradable—and if owned by nonresidents are to be classified as *banks, short-term, currency and deposits (other investment* in the IIP). Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *direct investment, intercompany lending* (see the description of *direct investment* in Chapter 3).

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. Because income and the repayment of principal are dependent on the performance of the underlying instruments, there is a probability of early repayment. 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. 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*, *bonds and notes (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 *money market instruments*. 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. So, 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, money market instruments (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, bonds and notes (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 *money market instruments*. Alternatively, depending

on the relationship between debtor and creditor, these securities could be classified as *direct investment, intercompany lending* (see the description of *direct investment* in Chapter 3).

Commodity-Linked Derivatives

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

- *Commodity future*—traded on an organized exchange, in which counterparties commit to buy or sell a specified amount of a commodity at an agreed contract price on a specified date;
- *Commodity option*—gives the purchaser the right but not the obligation to purchase (call) or sell (put) a specified amount of a commodity at an agreed contract price on or before a specified date; 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 counterparty is a nonresident are included indistinguishably in the memorandum item, *financial derivatives*.

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, bonds and notes (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 *money market instruments*. 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 item, *equity liabilities*. If the nonresident is in a direct investment relationship with the issuer, then the equity is classified as *Direct investment in reporting economy: equity capital and reinvested earnings* in the memorandum item.

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). 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. 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 the memorandum item, *financial derivatives*.

Credit-Linked Note

A so-called structured security that combines a credit derivative and a regular bond.

Classification

Credit-linked notes owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, bonds and notes (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 coin that are in circulation and commonly used to make payments.

Classification

Domestic currency owned by nonresidents is included within the gross external debt position as *monetary authorities* (or perhaps *banks), 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.

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, bonds and notes (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 *money market instruments*. 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. The World Bank guarantees that at least 90 percent of the U.S. dollar-equivalent value of the currency pool is maintained in fixed currency ratios of 1 U.S. dollar: 125 Japanese yen: 1 euro. These ratios have been maintained since 1991, and prior to the introduction of the euro, the currency ratios were maintained in a fixed ratio of 1 U.S. dollar: 125 Japanese yen: 2 deutsche mark equivalent (consisting of deutsche mark, Netherlands guilders, and Swiss francs). The currency amount disbursed is converted into a U.S. dollar equivalent amount, using the applicable exchange rate on the day of disbursements. The U.S. dollar equivalent amount is then divided by the pool unit value on the day of disbursement to determine the pool units disbursed. The pool units are what the borrower will have to repay. When pool units are to be repaid, they are converted back into the dollar equivalent amount using the prevailing pool unit value. Thus, the pool unit value may be thought of as an exchange rate used to convert the units into their equivalent value in U.S. dollars, and it changes daily in accordance with movements of the exchange rates of the currencies in the pool. The pool unit value is calculated by dividing the U.S. dollar equivalent of the currencies in the pool by the total number of pool units outstanding. As the U.S. dollar appreciates relative to other currencies in the pool, the pool unit value decreases.

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

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, bonds and notes* (*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 *money market instruments*. 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).

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, bonds and notes* (*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 *money market instruments*. 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 item, *equity liabilities*. If the nonresident is in a direct investment relationship with the issuer, then the equity is classified as *Direct investment in reporting economy: equity capital and reinvested earnings* in the memorandum item.

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 bank deposits. See *Bank Deposits*.

Classification

Deposits in mutual associations owned by nonresidents are to be included in the gross external debt position. They should be classified as *banks, 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, bonds and notes* (*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 *money market instruments*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *direct investment, intercompany lending* (see the description of *direct investment* in Chapter 3).

E

Equity

Equity securities cover all instruments and records acknowledging, after the claims of all creditors have been met, claims to the residual values of incorporated enterprises.

Classification

Equity securities are included in the memorandum item, *equity liabilities*. If the nonresident is in a

direct investment relationship with the issuer, then the equity is classified as *Direct investment in reporting economy: equity capital and reinvested earnings* in the memorandum item.

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, bonds and notes* (*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 *money market instruments*. 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 item, *equity liabilities*. If the nonresident is in a direct investment relationship with the issuer, then the equity is classified as *Direct investment in reporting economy: equity capital and reinvested earnings* in the memorandum item. 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 the memorandum item, *financial derivatives*.

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, bonds and notes (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 *money market instruments*. 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 the memorandum item, *financial derivatives*.

F

Fixed-Rate Bond

A bond whose coupon payments remain unchanged 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, bonds and notes (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 *money market instruments*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *direct investment, intercompany lending* (see the description of *direct investment* in Chapter 3).

Foreign Bonds

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

Classification

If the owner of the foreign bond is a nonresident, and this is most likely given that the bonds are issued in foreign markets, the bonds are to be included in the gross external debt position. They should be classified as *long-term, bonds and notes (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 *money market instruments*. 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 the memorandum item, *financial derivatives*.

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 the memorandum item, *financial derivatives*.

G

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. 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; so borrowing under a gold swap from a nonresident is included within the gross external debt position. The debt should be classified as a *loan (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, bonds and notes (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, money market instruments*. 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 treated as an interest cost, and added to the value of the underlying instrument.

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, with settlement based on the difference between the market rate and the specified rate times the notional value.

Classification

Interest-rate-linked derivatives in which the counterparty is a nonresident are included indistinguishably in the memorandum item, *financial derivatives*.

L

Land Ownership

By convention, land can only be owned by residents. So if a nonresident purchases land, 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 item, *Direct investment in reporting economy: equity capital and reinvested earnings.*

Letters of Credit

Letters of credit provide a guarantee that funds will be made available, 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.

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. Loans may be payable in the domestic or foreign currency(s).

Classification

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

M

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, bonds and notes (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 *money market instruments*. 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.

Miscellaneous Accounts Payable and Receivable

See *Other Accounts Payable and Receivable*.

Money Market Instruments

Money market instruments are debt securities that generally give the owner the unconditional right to receive a stated, fixed sum of money on a specified date. These instruments usually are traded, at a discount, in organized markets; the discount is dependent upon the interest rate and the time remaining to maturity. Included are such instruments as treasury bills, commercial and financial paper, banker's acceptances, negotiable certificates of deposit (with original maturities of one year or less), and short-term notes issued under note issuance facilities.

Classification

Money market instruments owned by nonresidents are to be included in the gross external debt position. They should be classified as *short-term, money market instruments (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).

Mortgage-Backed Securities

A mortgage-backed security is a form of asset-backed security. See *Asset-Backed Securities*.

Classification

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

Mutual Fund Shares

Mutual funds are financial institutions through which investors pool their funds to invest in a diversified portfolio of securities. 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, mutual 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. Usually, fund managers must adequately inform investors about the risks and expenses associated with investment in specific funds.

Classification

Because nonresidents own mutual fund shares, the shares are equity investments to be included in the memorandum item, *equity liabilities*.

N

Nondeliverable Forward Contracts (NDFs)

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

Classification

NDF contracts in which the counterparty is a nonresident are included indistinguishably in the memorandum item, *financial derivatives*.

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, bonds and notes (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 *money market instruments*. 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).

Nontraded Debt

Debt instruments that are not usually traded or tradable 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, money market instruments* (*portfolio investment, debt securities* in the IIP). This is because the contractual maturity is less than one year's maturity. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *direct investment, intercompany lending* (see the description of *direct investment* in Chapter 3).

O

Operational Leases

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

Classification

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

Other Accounts Payable and Receivable

Other accounts payable and receivable—see also *Trade Credit*—include amounts due in respect of taxes, dividends, purchases and sales of securities, rent, wages and salaries, and social contributions.

Classification

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

P

Participating Preferred Shares

Also known as a participating preference share. These are a type of preferred share where the

investor has some entitlement to a share in the profits or a share of any surplus on dissolution of the issuer (in addition to the fixed dividend payment received). See also *Preferred Shares* and *Nonparticipating Preferred Shares*.

Classification

Because of the claim on the residual value of the issuer, participating preference shares are classified as equity instruments, and so are included in the memorandum item, *equity liabilities*. If the nonresident is in a direct investment relationship with the issuer, then the equity is classified as *Direct investment in reporting economy: equity capital and reinvested earnings* in the memorandum item.

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, bonds and notes (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 *money market instruments*. 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-two capital under the Basel capital adequacy requirements. 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, bonds and notes (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 *money market instruments*. 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.

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 money market instruments 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, money market instruments (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 *bonds and notes*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *direct investment, intercompany lending* (see the description of *direct investment* in Chapter 3).

R

Reverse Security Transactions

See Appendix II.

S

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 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, money market instruments* (original maturity of one year or less) or *long-term, bonds and notes* (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.

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

Classification

Structured floating-rate notes are debt instruments, and if owned by a nonresident are to be included in the gross external debt position. They should be classified as *long-term, bonds and notes* (*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 *money market instruments*. 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 the memorandum item, *financial derivatives*.

T

Total Return Swap

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

Classification

Total return swaps in which the counterparty is a nonresident are included in the memorandum item, *financial derivatives*.

Trade Credit

Trade credits consist of claims and 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). The direct extension of trade credit by buyers arises when they prepay for goods and services; the debt is extinguished when the supplier provides the goods and/or services.

Classification

Trade credit owed to nonresidents is to be included in the gross external debt position. Such credit should be classified as *trade credit (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). *1993 SNA* regards trade credit as a form of accounts payable/receivable (*1993 SNA,* paragraph 11.100).

Treasury Bills

A common form of sovereign short-term debt; many governments of the world issue treasury bills. Typi-

cally 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, money market instruments (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, bonds and notes*.

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. Use of IMF credit and loans includes purchases and drawings under Stand-By, Extended, Structural Adjustment, Enhanced Structural Adjustment, and Systemic Transformation Facility Arrangements, together with Trust Fund loans.

Classification

Use of IMF credit and loans is to be included in the gross external debt position as *monetary authorities, loans (other investment* 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, bonds and notes (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 *money market instruments*. Alternatively, depending on the relationship between debtor and creditor, these securities could be classified as *direct investment, intercompany lending* (see the description of *direct investment* in Chapter 3).

Variable-Rate Notes (VRNs)

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

Classification

VRNs owned by nonresidents are to be included in the gross external debt position. They should be classified as *long-term, bonds and notes (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 *money market instruments*. 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 the memorandum item, *financial derivatives*.

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 advantages 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, bonds and notes (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 *money market instruments*. 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.

Arrears: When Should They Be Recorded?

Arrears should be recorded from the day after a required payment has not been made. It is recognized that, in some instances, arrears arise for operational reasons rather than a reluctance or inability to pay. Nonetheless, in principle such arrears when outstanding at the reference date should be recorded as arrears.

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.

Defeasement

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. Defeasance may be carried out by placing the paired assets and liabilities in a separate account within the institutional unit concerned or by transferring them to another unit. The *Guide* does not recognize defeasance as affecting the outstanding debt of the debtor as long as there has been no change in the legal obligations of the debtor. In other words, provided the payment obligations remain de jure with the original debtor, ownership of the liabilities remains unchanged, and should be reported as external debt of the original debtor.

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. The IMF's *Balance of Payments Textbook* (IMF, 1996, page 126) provides an example of the circumstance in which there is a final residual payment.

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[2]

Activities of Islamic financial institutions differ from those of standard commercial depository cor-

[2]Islamic banking is described in detail in Appendix 2 of the IMF's *Monetary and Financial Statistics Manual* (IMF, 2000d).

porations in that predetermined interest on financial transactions is prohibited. As is evident from the definition of external debt in Chapter 2, the nonpayment of interest on liabilities does not in itself preclude instruments from being classified as external debt. 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 Qard-hasan 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 tradable securities.

Islamic instruments—debt securities consist of various investment participation certificates that have the characteristics of tradable securities and are not permanent capital of an institutional unit. Included in this category are the most tradable 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.

Nonlife Insurance

For nonlife insurance the following transactions result in external debt:

- Any prepayments of premiums by nonresidents are classified as external debt of the insurance company, under *other debt liabilities*.
- Reserves that are held against outstanding claims of nonresidents—that is, claims that have arisen because an event has occurred that results in a valid claim—are also external debt of the insurance company. Again, these reserves are included in *other debt liabilities*.

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 on-lend 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.

Part-Payments for Capital Goods

For capital goods with long delivery periods, such as ships, the purchaser may make part-payments to the builder or exporter while the good is being produced. These part-payments should be recorded as trade credit debt of the exporter. The debt is extinguished when the purchaser takes delivery of the good.

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*. Also, unless the agreed date for payment is past, neither the prepayment nor postpayment of goods and services should be recorded as arrears.

Processing of Goods

In *BPM5*, when goods are exported across a border for processing with the intention that the processed goods are returned to the exporting economy, a goods transaction should be recorded in the balance of payments—an import of the processing economy from the original economy. In such circumstances, a corresponding financial liability is established and recorded as external debt under *trade credit*. When the processed good is returned, the financial liability is extinguished. If the amounts are significant, it is recommended that such trade credit be separately identified (as is recommended in the trade account of the balance of payments).

Project Loans: Disbursements

Disbursements of project loans can take the form of

- 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 repre-

sent 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 *Nonlife Insurance*, 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.

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.

Appendix II. Reverse Security Transactions

1. A reverse securities transaction is defined in the *Guide* 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 the securities were acquired initially. These arrangements are known as repurchase agreements (repos), securities lending, and sell-/buybacks.[1] Where cash is involved, the economic nature of the agreement is similar to that of a collateralized loan in that the purchaser of the security is providing funds collateralized by the securities to the seller for the period of the agreement and is receiving a return from these funds through the agreed fixed price at which the securities are resold when the agreement is reversed.

2. As outlined in Chapter 3, securities that are provided under a reverse securities transaction are reported as remaining on the balance sheet of the security provider. If the security taker sells outright these securities so acquired, the security taker reports a negative (or "short") position in the security.

3. This appendix provides some background information on reverse security transactions and some examples of how these positions should be recorded in the gross external debt position.

What Are These Instruments?

Repurchase Agreements (Repos)

4. Under a repo, securities are provided for cash with a commitment by the seller (security provider) to repurchase the same or similar securities for cash at a fixed price on a specified future date. The security taker views the transaction as a *reverse repo*. The security taker earns interest on the cash advanced through the difference between the selling and buying rates for the securities; interest is related to the current interbank rate and not that of the security being "repoed."[2] Full, unfettered ownership passes to the security taker, who can on-sell the security, but the market risk—the benefits (and risks) of ownership (such as the right to holding gains—and losses)—remains with the security provider, who also receives the property/investment income attached to the security, albeit from the security taker rather than the security issuer. Originally, it was intended that the security taker's right to on-sell would be invoked only in the event of a default by the security provider, but as the market has developed, the right to on-sell at the security taker's option has become commonplace.

5. Repos are actively used in international financial markets. They often have a very short overnight maturity, but are also for longer maturities (sometimes up to several weeks), or have an "open" maturity (that is, the parties agree daily to renew or terminate the agreement). Several different types of institutions are involved. Most commonly, financial institutions transact with other financial institutions, both domestic and nonresident, and central banks with domestic financial institutions and other central banks. However, nonfinancial enterprises and governments may also use repos.

6. Repos are undertaken for a variety of reasons:

- To finance security purchases—that is, the security provider acquires a security outright and then sells it under a repo to help finance the position;

[1] Sell-/buybacks are the same as repos in economic effect, but are less sophisticated operationally. If the seller acquires an option rather than an obligation to buy back the security, the arrangement is sometimes called a *spurious repurchase agreement*. Such a transaction is not considered to be a reverse security transaction in the *Guide*.

[2] In the event that a coupon payment is made during the life of the repo, this is taken into account when determining the funds to be repaid. However, market participants endeavor to avoid such a situation if possible.

- To increase liquidity by raising funds while retaining exposure to market price movements in the security—that is, the security provider may want a longer-term position in the security but may also require cash in the short term;
- To acquire securities in order to cover a negative (or "short") position—that is, the security taker takes a negative position in the security, thus benefiting from market price declines;
- To take leverage positions in securities through a program of buying securities, repoing them out, purchasing more securities with the cash acquired and so on, with only the requirement for margins limiting this activity—that is, the security provider creates a large positive exposure to movements in the price of the securities without having to fully fund this exposure with own funds;
- Central banks use repos as an operational tool to ease or drain liquidity in the domestic financial markets—in many countries, the repo rate (the rate paid by the borrower in a repo transaction) is the benchmark rate for central bank market lending.

7. Chains of repos and reverse repos are common practice in financial markets as highly creditworthy market players raise funds at lower rates than they are able to on-lend. In this manner, the repo market is part of broader financial intermediation activity.[3] The development of repo markets can increase the liquidity of a money market while, at the same time, deepening the market for the underlying securities used (frequently government securities, but not necessarily), leading to finer borrowing rates both for money market participants and governments.

8. Usually, the security provider in a repo is the initiator of the transaction, which tends to place the security taker in a slightly stronger negotiating position. These are called "cash-driven" repos. In these circumstances, the security provider is not required to provide a specific security—a list of acceptable securities is generally available. Frequently, substitution of the security is permitted during the life of the repo—that is, the security provider may wish to access the security repoed and so usually is permitted to do so by substituting it for another of equal quality (generally, one on the list of acceptable securities). The right to substitute securities will usually affect the rate of interest charged on the repo.

9. In certain circumstances, one party may have need for a specific type of security. These transactions are known as "securities-driven" repos. They result when a particular security goes "special"—that is, is in very high demand and there is insufficient supply to meet commitments. In these circumstances, cash is provided as collateral (noncash collateral is discussed under *Securities Lending,* below) and the security provider is in a stronger bargaining position. In essence, when a security-driven transaction takes place, the security provider is prepared to accept cash in return for the security "lent," provided that the provider can be compensated for the risk of lending by obtaining a sufficient spread between the interest to be paid on the cash received and what can be earned in the money market. In extreme cases, when the security may be unavailable from any other source, the interest rate on the cash received may fall to zero.

10. Whether a transaction is cash-driven or securities-driven will affect which party pays *margin*. Margin payments provide one party with collateral of greater market value than the instrument being provided—the term "haircut" is sometimes used to describe this difference. Margin payments may be made at the outset—known as *initial margins*—and during the life of a repo—known as *variation margin*.[4] As the market value of the collateral falls, so variation margin is paid, restoring the margin to its original market value. If the transaction is cash-driven, the security provider will provide the margin; if the transaction is securities-driven, the security taker will provide the margin. Margin may be cash or securities.

11. Market and credit risk affect the amount of margin provided. The market risk is that of the underlying security—the more variable the market price of the security, the greater the margin; the credit risk is that of the two counterparties to the repo to each other—the greater the perceived credit risk of the

[3]Repo market players may have matched or unmatched books: in a matched book, maturities of all repos out are the same as those for repos in; in an unmatched book, the maturities differ, in which case the market player is speculating on movements in the yield curve.

[4]Sale-/buybacks do not have margin payments.

margin provider, the higher the margin. In both instances, the higher margin protects the margin taker against the higher probability of adverse developments. Because each party at the inception of a repo is equally exposed to risk, in many developed financial markets, initial margin may not be required if the credit standing is approximately equal (monetary authorities usually ask for initial margin and rarely, if ever, pay initial margin), but variation margin is usually provided when the market price of the security falls. On the other hand, when the value of the security rises, the security taker may or may not return part of the security's value as a "reverse variation margin," depending on the market's practices in any given country. In less developed capital markets, and depending on the depth and price volatility of the market of the security underlying the repo, initial margins of substantially more (possibly up to 25 percent) than the value of the cash provided may be required.

12. The legal and market arrangements for repos, including the payments of margin (whether initial or variation), the ability to substitute securities, and the retention of market risk by the security provider, support the view that repos are classified as loans, with the security remaining on the balance sheet of the security provider. This is certainly the way repos are viewed by market participants. On the other hand, given the change of ownership of the security, some argue that a security transaction should be recorded—the security provider no longer has a legal claim on the security issuer. In Chapter 4 a memorandum table to the gross external debt position is provided that can be used to present data on resident-issued debt securities that residents (1) provided to and (2) acquired from nonresidents under outstanding reverse transactions, including repo agreements. This table helps in tracking the change of ownership of these debt securities between residents and nonresidents and, more generally, the positions acquired under reverse transactions.

Securities Lending

13. Under a *securities lending agreement*, securities are provided under a legal agreement that requires the security taker to return the same or similar securities on or by an agreed date to the same party from whom the securities were acquired initially. No cash is provided by the security taker to the security provider in return for the acquisition of the securities, although a fee may be paid by the security taker and collateral provided (as in the form of other securities). If cash collateral is provided, the transaction has the same economic impact as a repo.

14. As with repos, full, unfettered ownership passes to the security taker, who can on-sell the security, but the market risk—the benefits (and risks) of ownership (such as the right to holding gains—and losses)—remains with the original owner of the security, who also receives the property/investment income attached to the security, albeit from the security taker rather than the security issuer. Because securities lending is a securities-driven activity, so the security taker initiates the transaction, which means that the bargaining advantage lies with the "lender" of the security. The level of the fee charged depends on the availability of the security. The payment may be made at inception or at the closeout of the contract. In most cases, the original security owner considers the arrangements to be temporary and does not remove the securities or include the collateral on its balance sheet, since the owner retains the rights to any dividends or interest while the securities are on loan, albeit from the security taker rather than the security issuer.[5]

15. Security loans are actively used in financial markets. In many cases, the transfer of securities between holders is conducted by security depositories. The security owner will provide the depository with the general right to on-lend the securities subject to certain legal safeguards. As a consequence, frequently the owner of the security will be unaware that the security it owns has been sold under a securities loan agreement.

16. The primary purposes of securities lending are:

- For the security taker, the security is acquired in order to meet a commitment to sell the security—that is, to cover a negative (or "short") position.

[5]In instances where equities are loaned, the period of the loan usually avoids coinciding with a shareholders' meeting, or any other instance where voting rights are required to be exercised (such as for a takeover bid). However, it is not always possible to know when these situations will arise, and the arrangements usually permit the return of the equities to the original owner in such circumstances.

The security taker can take leverage positions by selling securities it does not own and then covering the position with securities acquired under securities loans.
- For the security provider, the fee paid by the security taker generates income—the owner has a long-term position in the security, but through a securities loan earns additional income.
- The depository can earn extra fee income, which might be partially passed on to the security owner through lower custodial fees. The depository is more likely to be able to manage the collateral provided by the security taker than the security owner, who, in return for allowing securities to be lent, may pay lower custodial fees and not have the responsibility of managing the collateral provided.

17. Like repos, chains of securities lending can be established whereby brokers successively on-lend securities to brokers, dealers, or other parties. The lending chains are reversed when the securities are returned. Securities lending involves securities that may be issued by residents or nonresidents, by governments or by corporations, and can be either equities or debt instruments. Securities lending increases liquidity in the securities market as well as the timeliness of some trade settlements—especially for securities that trade infrequently or in small volume.

18. The securities taker will usually provide collateral in the form of other securities of equal or greater value to the securities "lent," providing initial margin, although in some instances no collateral is provided. If cash collateral is provided, the transaction has the same economic impact as a repo (discussed above). If the market value of securities placed as collateral falls relative to the value of the securities "loaned," the securities taker is usually required to place variation margin, to restore the relative position. If the value of the securities placed as collateral increases, the securities provider may or may not be required to return part of the collateral, depending on country practice.

19. Because of the requirement for the securities to be returned, the payments of margin, the retention by the original security owner of the market risks of the securities, and the right to receive income payments on the security, securities lent under security loans remain on the balance sheet of the original owner. If a security taker sells the security acquired under a security loan, a negative (or "short") position is recorded in the security, reflecting the obligation to return the security to the security provider. As noted above, Chapter 4 provides a memorandum table to the gross external debt position that can be used to present data on resident-issued debt securities that residents (1) provided to and (2) acquired from nonresidents under outstanding reverse transactions, including security lending agreements.

Recording Examples

20. To help compilers, some examples are set out in Table A2.1 of how different types of reverse security transactions should be recorded in the gross external debt position and in the memorandum table, when debt securities are involved.[6] These examples show the change in the position when resident-issued debt securities are acquired by a nonresident from a resident, or vice versa, under a reverse security transaction. In all these examples, it is assumed that debt securities involved in the transactions are valued at 100, and any cash provided is valued at 95. Each example involves a transaction in a debt security issued by a resident of A. Each example specifies an initial transaction, followed by different subsequent transactions. For each subsequent transaction, the recorded entries include both the initial transaction and the subsequent transaction. So, the entries for example 1(b) include both the sale of the debt security under a repo by a resident of A to a nonresident (1(a)), and the subsequent sale under a repo by the nonresident to another resident of A (1(b)); the entries for example 1(c) include both the sale of the debt security under a repo by a resident of A to a nonresident (1(a)), and the subsequent sale under a repo by the nonresident to another nonresident (1(c)).

[6]When equity securities are involved in reverse security transactions, external debt is affected only if the equity securities are used as collateral to raise cash from a nonresident. In this instance, a loan is recorded.

Table A2.1. External Debt: Recording of Reverse Security Transactions

Transaction	Change in the Gross External Debt Position		Memorandum Items: Debt Securities Acquired Under Reverse Security Transactions: Change in the Position	
	Debt securities (+ = increase)	Loans (+ = increase)	Acquired by nonresidents from residents (+ = increase)	Acquired by residents from nonresidents (– = increase)
Example 1: Repurchase agreement (repo)				
(a) Resident of A sells the security under a repo to a nonresident	—	+95	+100	—
(b) Following 1(a), the nonresident sells the security under a repo to another resident of A	—	+95	+100	–100
(c) Following 1(a), the nonresident sells the security under a repo to another nonresident	—	+95	+100	—
(d) Following 1(a), the nonresident sells the security outright to a resident of A	–100	+95	+100	—
(e) Following 1(a), the nonresident sells the security outright to another nonresident	—	+95	+100	—
Example 2: Repurchase agreement (repo)				
(a) Resident of A buys the security under a repo from a nonresident	—	—	—	–100
(b) Following 2(a), the resident sells the security under a repo to another resident of A	—	—	—	–100
(c) Following 2(a), the resident sells the security under a repo to a nonresident	—	+95	+100	–100
(d) Following 2(a), the resident sells the security outright to another resident	—	—	—	–100
(e) Following 2(a), the resident sells the security outright to a nonresident	+100	—	—	–100
Example 3: Security loan				
(a) Resident of A "sells" the security under a security loan to a nonresident	—	—	+100	—
(b) Following 3(a), the nonresident "sells" the security under a security loan to another resident of A	—	—	+100	–100
(c) Following 3(a), the nonresident "sells" the security under a security loan to another nonresident	—	—	+100	—
(d) Following 3(a), the nonresident sells the security outright to a resident of A	–100	—	+100	—
(e) Following 3(a), the nonresident sells the security outright to another nonresident	—	—	+100	—
Example 4: Security loan				
(a) Resident of A "buys" the security under a securities loan from a nonresident	—	—	—	–100
(b) Following 4(a), the resident "sells" the security under a security loan to another resident of A	—	—	—	–100
(c) Following 4(a), the resident "sells" the security under a security loan to a nonresident	—	—	+100	–100
(d) Following 4(a), the resident sells the security outright to another resident of A	—	—	—	–100
(e) Following 4(a), the resident sells the security outright to another nonresident	+100	—	—	–100

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.

Affiliated Enterprises

Enterprises related through direct investment ownership structures, such as branches, subsidiaries, associates, and *joint ventures*. Affiliated enterprises include those in a direct ownership relationship but also those that are related through a third enterprise and/or a chain of direct investment relationships. For a fuller exposition of direct investment relationships, see the *OECD Benchmark Definition of Foreign Direct Investment* (OECD, 1996, pp. 9–12).

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*.

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 (OECD Consensus)

The Arrangement (sometimes known as the Consensus) 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. Additionally, there are three Observers: the Czech Republic, Hungary, and Poland.

B

Balance of Payments

The balance of payments is a statistical statement that systematically summarizes, for a specific period of time, the economic transactions of an economy with the rest of the world. Transactions, for the most part between residents and nonresidents, consist of those involving goods, services, and income; those involving financial claims and liabilities to the rest of the world; and those (such as gifts) classified as transfers.

Bank for International Settlements (BIS)

Established in 1930 by intergovernmental convention, the Bank for International Settlements promotes cooperation among central banks. In this capacity it carries out four main functions: it holds and manages deposits from a large number of central banks throughout the world; it serves as a forum for international monetary cooperation; it assists as agent or trustee in the execution of various international financial agreements; and it carries out research and issues publications on monetary and economic subjects.

Berne Union

The International Union of Credit and Investment Insurers. This Union is an informal association of export credit insurance 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 twice a year to exchange information and seek to establish common standards, for instance on the appropriate down payment and repayment periods for various kinds of exports. Informal credit ratings of the borrowing countries are maintained. 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 *credito*r countries. 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 country, extends a loan directly to a foreign buyer or to a bank in the importing country to pay for the purchase of goods and services from the exporting country. Also known as financial credit. This term does not refer to credit extended directly from the buyer to the seller (for example, through advance payment for goods and services).

C

Capital Account

In the *balance of payments*, the capital account covers *capital transfers* and the acquisition or disposal of nonproduced nonfinancial items (for example, patents).

Capital Transfers

Capital transfers consists of the transfer—without a quid pro quo—of ownership of a fixed asset or the forgiveness, by mutual agreement between *creditor* and debtor, of the debtor's financial liability when no counterpart is received in return 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 the *principal* amount. 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-country guarantor fails to pay. These 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 countries 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.

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 major OECD countries. CIRRs have been established for 13 currencies, the majority of which are based on either the five-year government bond yields or on three-, five- and seven-year bond yields, according to the length of the repayment period. 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* (see above), commitment simply refers to any statement, in whatever form, whereby the willingness or intention to provide official support is communicated to the recipient country, 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 a country 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 conces-

sionality 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 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* payments 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)

The principal characteristic of a contingency is that one or more conditions must be fulfilled before a financial transaction takes place.

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 country that prevent the remittance of *debt-service* payments.

Creditor

An entity with a *financial claim* on another entity.

Creditor Country

The country 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, to monitor the debt of developing countries. Major creditor countries, primarily the 22 member countries of the Development Assistance Committee (DAC), together with the European Commission, supply information. The data are published in the OECD's annual *External Debt Statistics* publication.

Cross-Border Positions

Asset and liability positions of residents of an economy vis-à-vis residents of all other economies.

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 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 of the *balance of payments* covers all transactions (other than those in financial items) that involve economic values and occur between residents and nonresident entities. Also covered are offsets to current economic values provided or acquired without a quid pro quo. Included are goods, services, income, and *current transfers*. The balance on goods, services, income, and current transfers is commonly referred to as the "current balance" or "current account" balance.

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.

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 industrial country, 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

The assumption of a debt liability of one entity by another entity, usually by mutual agreement.

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, such as 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 a country 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 country 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-currency-denominated 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 country 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 country 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 debt securities, loans, trade credit, and currency and deposits. 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 *BPM5*, 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 arises from bilateral arrangements involving both the *creditor* and the debtor that alter the terms established for the servicing of a debt. This includes debt rescheduling, refinancing, forgiveness, conversion, and prepayments.

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, that 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 a country'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 a country's medium- to long-term debt situation. A country'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 country concerned.

Debt Swaps

Debt swaps are exchanges of debt, such as loans or 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 country (also known as *debt conversion*).

Debt Workout

The process of working out a satisfactory method whereby the debtor country can repay external debt, including restructuring, adjustment, and the provision of new money.

Debtor Country

The country in which the debtor resides.

Debtor Reporting System (DRS)

A statistical reporting system maintained by the World Bank to monitor the debt of developing countries. Information is supplied through reports from debtor countries. The data supplied are the basis for the annual World Bank report, *Global Development Finance* (formerly *World Debt Tables).*

Decision Point

In the context of the *HIPC Initiative*, the point at which a country'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 country and its capacity to service those obligations. If external debt ratios for that country 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 a country's eligibility, and the international community will commit to provide sufficient assistance by the completion point for the country 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

Established in 1960 as the Development Assistance Group, with the objective of expanding the volume of resources made available to developing countries and to improve their 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, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States, and the Commission of the European Communities.

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

The 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.

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 a country'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 country* 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 country*. 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 country are known as *buyer's credits*. (See also *Officially Supported Export Credits*.)

Export Credit Agency

An agency in a *creditor country* that provides insurance, guarantees, or loans for the export of goods and services.

Extended Fund Facility (EFF)

An IMF lending facility established in 1974 to assist member countries in overcoming *balance of payments* problems that stem largely from structural problems and require a longer period of adjustment than is possible under a *Stand-By Arrangement*. A member requesting an Extended Arrangement outlines its objectives and policies for the whole period of the arrangement (typically three years) and presents a detailed statement each year of the policies and measures it plans to pursue over the next 12 months. The phasing and performance criteria are comparable to those of Stand-By Arrangements, although phasing on a semiannual basis is possible. Countries must repay EFF resources over a period of 4½ to 10 years. (See *Stand-By Arrangement*.)

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

The amount of *principal* to be repaid (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.

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, and claims on nonresidents. The foreign liabilities of an economy consist of claims of nonresidents on residents. The primary basis for classification of the financial account is functional: direct, portfolio, and other investment, financial derivatives, and reserve assets.

Financial Asset

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. Most financial assets differ from other assets in the system of national accounts in that they have counterpart liabilities on the part of another institutional unit.

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 companies whose main business (originally, primarily shipping—but increasingly, production or services) is outside the country.

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 Flows of Financial Resources to Aid Recipients (Annual)

An annual publication of the OECD that shows the sources of official development financing to individual developing countries and territories. Included in this publication are detailed data on the geographical distribution of net and gross disbursements, commitments, terms, and the sectoral allocation of commitments.

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 country* 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 country. 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 country and used in the borrowing country to the benefit of that

country. These transactions are treated as grants 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 grants is not consistent with *BPM5* recommendations. In *BPM5*, grants are regarded as transfers: 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. For further details, see *1993 SNA,* paragraphs 2.171–2.174.

Gross National Product (GNP)

GDP plus net income from abroad. For further details, see *1993 SNA*, paragraphs 7.16 and 7.17. In the *1993 SNA*, GNP was renamed gross national income.

H

Heavily Indebted Poor Countries (HIPCs)

Group of 41 developing countries 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 GNP per capita income of $9,266 or more in 2000.

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 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.

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 multilaterals. 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 Country

The country of residence of the head office of the institutional entity.

Host Country

The country in which the institutional entity 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. Nonconcessional resources are provided mainly under *Stand-By Arrangements* and the *Extended Fund Facility* (EFF), and concessional resources are provided under the *Poverty Reduction and Growth Facility* (PRGF).

Institutional Sector

The grouping of institutional units with common economic objectives and functions. (See also S*ector Classification*.)

Institutional Unit

In the *1993 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 between institutional units be they households or corporations. An institutional unit is defined in the *1993 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" (*1993 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 country* that may prevent the remittance of *debt-servic*e 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)

For these data, the term "international" refers to banks' transactions in any currency with nonresi-

dents plus their transactions in foreign (nonlocal) currency with residents.

International Development Association (IDA)

IDA, established in 1960, is the concessional lending arm of the *World Bank Group*. IDA provides low-income developing countries 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 the stock of external financial assets and liabilities on a specified reference date, usually the end of the quarter or year. The change in position between two end-periods reflects financial transactions, valuation changes, and other adjustments occurring during the period.

International Monetary Fund (IMF)

Following the Bretton Woods Accords and established in 1945, the IMF is a cooperative intergovernmental monetary and financial institution with 184 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.

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. Also, 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 GNP per capita income of $755 or less in 2000.

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 GNP per capita income of between $756 and $2,995 in 2000.

Lyon Terms

See *Concessional Restructuring*.

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.”

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 institutions such as the IMF and the World Bank, as well as other multilateral development banks.

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.

N

Naples Terms

See *Concessional Restructuring*.

Nationality

Country 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. But 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.

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.

O

OECD Working Party on Export Credits and Credit Guarantees

This is a forum for discussing *export credit* issues and for exchanging information among 28 of the 29 member countries of the OECD (only Iceland does not participate).

Official Development Assistance (ODA)

Flows of official financing 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). By convention, ODA flows comprise contributions of donor government agencies, at all levels, to developing countries ("bilateral ODA") and to multilateral institutions. 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 country 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.

Organisation for Economic Co-operation and Development (OECD)

The OECD provides governments of its member countries with a setting in which to discuss, develop, and perfect economic and social policy. The exchanges may lead to agreements to act in a formal way, but more often, the discussion makes for better-informed work within government on the spectrum of public policy and clarifies the impact of national policies on the international community. The chance to reflect and exchange perspectives with other

countries similar to their own is provided. The OECD's objectives are to promote growth, employment, free trade, and a rising standard of living in both member countries and nonmember countries.

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 country* 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."

P

Paris Club

An informal group of creditor governments that has met regularly in Paris since 1956 to reschedule bilateral debts; the French treasury provides the secretariat. Creditors meet with a debtor country to reschedule its debts as part of the international support provided to a country that is experiencing debt-servicing difficulties and is pursuing an adjustment program supported by the IMF. The Paris Club does not have a fixed membership, and its meetings are open to all official creditors that accept its practices and procedures. The core creditors are mainly OECD member countries, but other creditors attend as relevant for a debtor country. Russia became a member in September 1997.

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.

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 is available to those countries that are facing protracted balance of payments problems and are eligible to borrow on concessional terms under the *International Development Association* (IDA). The PRGF supports programs that are consistent with strategies elaborated by the borrowing country in a Poverty Reduction Strategy Paper (PRSP). The PRSP is a comprehensive, nationally owned strategy that is prepared by the borrowing country and endorsed in their respective areas of responsibility by the Boards of the IMF and World Bank. Funds are provided at an annual interest rate of 0.5 percent. They are repayable over 10 years, including a grace period of 5½ years. (See *Structural Adjustment Facility*.)

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 country. 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 Debt

The debt obligations of the public sector.

Public External Debt

The *external debt* obligations of the public sector.

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

Recoveries

Repayments made to an *export credit agency* by a borrowing country 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. Also, 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.

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 country 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 *1993 SNA* and *BPM5*, institutional sectors are formed by the grouping of similar kinds of institutional units according to their economic objectives and functions.

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*.)

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 Arrangement

An IMF lending facility established in 1952 through which a member country can use IMF financing up to a specified amount to overcome short-term or cyclical *balance of payments* difficulties. Installments are normally phased on a quarterly basis, with their release conditional upon the member's meeting performance criteria, such as monetary and budgetary targets. These criteria allow both the member and the IMF to assess the member's progress in policy implementation and may signal the need for further corrective policies. Stand-By Arrangements typically cover a period of one to two years (although they can extend up to three years). Repayments are to be made over a period of 3¼ to 5 years. The expected repayment period is shortened to 2¼–4 years if the country's external position allows it to repay earlier.

Stand-By Credit

A commitment to lend up to a specified amount for a specific period, to be used only in a certain contingency.

Standstill

This is an interim agreement between a *debtor country* 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 country 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* in November 1999. (See *Poverty Reduction and Growth Facility*.)

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.

T

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 country 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 country* from the *creditor country*.

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 country to the recipient country.

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 country. 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-middle-income those countries with GNP per capita income of between $2,996 and $9,265 in 2000.

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

A financial claim that a creditor regards as unrecoverable and so no longer carries on its books.

Appendix IV. Relationship Between the National Accounts and the International Investment Position (IIP)

1. In the *Guide*, linkages between external debt statistics, the IIP, and the national accounts have been developed and explained. This appendix goes further and explains the relationship between the national accounts and the IIP, such that data on the IIP can be incorporated into the external account components of the rest of the world account of the national accounts system, bringing compilation and collection efficiency gains as well as analytical benefits.

2. There is virtually complete concordance between the *1993 SNA* and *BPM5* with respect to such issues as the delineation of resident units, valuation of transactions and of the stock of external assets and liabilities, time of recording of transactions in goods and services, income flows, current transfers, capital transfers, external assets and liabilities, and coverage of the IIP. There are, however, differences in classification between the rest of the world account and *BPM5*. These reflect, inter alia, differences in analytical requirements and the need in the *1993 SNA* to adopt a uniform classification scheme for all sectors of the economy. In this appendix, the financial account element of the national accounts is examined, followed by a detailed comparison between the financial accounts and the IIP.

Financial Accounts

Features of Financial Accounts

3. The key features of financial accounts are that (1) they identify the liabilities that net borrowing institutional sectors use to finance their deficits, and the financial assets that net lending sectors use to allocate their surpluses; (2) they facilitate analysis of the flow of funds between different institutional sectors of the economy; (3) they place emphasis on stock variables such as financial assets and debt; and (4) they are developed from detailed information on the various institutional sectors and their activities in financial assets/liabilities.

4. The complete system of financial accounts, including flow of funds accounts,[1] has considerable analytical power. For instance, corporate sector gross debt-equity ratios can be calculated; related shifts by households or companies into financial deficit (defined relative to GDP) can be observed; and increases in income gearing (interest payments as a proportion of income), shifts in the pattern of intermediation toward or away from the banking sector (as shown by the total assets of banks relative to nonbank financial institutions), and rapid growth of lending in any individual market to a given sector can be monitored. Furthermore, information on investment patterns of institutional investors, the balance between sources of corporate debt finance in banking and bond markets (to assess vulnerability to crises in different institutions or markets), and the maturity of debt (on an original maturity basis) is also available.

Financial Assets

5. Financial accounts deal with stocks of financial assets owned by institutional sectors and transactions in these assets through financial markets. In the *1993 SNA* and the *European System of Accounts 1995 (ESA95)*,[2] financial assets are defined as entities over which ownership rights are enforced and from which economic benefits may be derived by their owners by holding them or using them, over a period of time (paragraph 11.16 of the *1993 SNA)*. In short, financial assets are stores of economic value. Most financial assets differ from other assets in that there are counterpart liabilities on behalf of another institutional unit.

6. The *1993 SNA* distinguishes eight types of financial assets:

[1]Flow of funds accounts provide information on financial transactions among institutional sectors (for more details, see paragraphs 11.103–11.111 and Table 11.3a of the *1993 SNA*).

[2]The *ESA95* (Eurostat, 1996) is the system of national accounts used by member states of the European Union. Unless otherwise stated, the *ESA95* treatment is consistent in all aspects with the *1993 SNA*.

Table A4.1. Classification by Sector in *1993 SNA*

Nonfinancial corporations (S.11)
Financial corporations (S.12)
- Central bank (S.121)
- Other depository corporations (S.122)
- Other financial intermediaries (except insurance corporations and pension funds) (S.123)
- Financial auxiliaries (S.124)
- Insurance corporations and pension funds (S.125)

General government (S.13)[1]
- Central government (S.1311)
- State government (S.1312)
- Local government (S.1313)
- Social security funds (S.1314)

Households (S.14)

Nonprofit institutions serving households (S.15)

Rest of the world (S.2)

Note: The abbreviations given in brackets are the sectors as they are numbered in the *1993 SNA*.
[1]The *1993 SNA* also includes an alternative presentation of the general government sector. This alternative presentation attributes social security funds to the level of government at which they operate, leaving three subsectors: Central government plus social security funds operating at the central government level (S.1321); State government plus social security funds operating at the state government level (S.1322); and Local government plus social security funds operating at the local government level (S.1323).

- Monetary gold and special drawing rights (SDRs) (AF.1);
- Currency and deposits (AF.2);
- Securities other than shares (AF.3);
- Loans (AF.4);
- Shares and other equity (AF.5);
- Insurance technical reserves (AF.6);
- Financial derivatives (AF.7); and
- Other accounts receivable/payable (AF.8).

Most financial assets are further disaggregated, in particular according to maturity and market type. Thus, transferable deposits and other deposits (for example, nontransferable savings deposits) are included within currency and deposits, while within securities other than shares, a distinction is made between short-term and long-term securities.

Institutional Sectors

7. The *1993 SNA* groups the institutional units of a national economy into five mutually exclusive institutional sectors: nonfinancial corporations, financial corporations, general government, households, and nonprofit institutions serving households (NPISH) (Table A4.1). With regard to financial corporations, a distinction is made between the central bank, other depository corporations (other monetary financial institutions in the *ESA95*), other financial institutions (except insurance corporations and pension funds), financial auxiliaries, and insurance corporations and pension funds. The general government is also divided in four subsectors: central government, state government, local government, and social security funds. In the *ESA95* (paragraph 2.49) the central bank and other financial corporations are grouped together in the monetary financial institutions (MFIs) sector. Also, the *ESA95* divides the rest of the world sector into European Union (EU), and nonmember countries and international organizations.

Table A4.2. Link Between the Accounts

Flows (change to financial assets and liabilities)
  Financial account transactions
  Other changes in volume of assets account
  Revaluation account
Stocks (stocks of financial assets and liabilities)

The Link Between the Accounts

8. Changes in stocks of financial assets and liabilities from one accounting point to another are the consequence of a combination of economic flows. These include financial transactions, valuation changes, and other changes, such as write-offs and transfers of assets/liabilities resulting from, say, an institutional unit changing sectors. In the *1993 SNA* flows and stocks are completely integrated—that is, changes in the stock or balance sheet positions[3] of the institutional units can be fully explained by recorded flows (Table A4.2).

A Simplified Version of Financial Account Balance Sheets

9. As mentioned above, the economy consists of five resident sectors—nonfinancial and financial corporations, general government, households, and NPISH—all of which have relationships with the rest of the world sector. Figure A4.1 is a matrix of

[3]Balance sheets are statements, at a particular point in time, of the value of the stock of nonfinancial assets and financial assets and liabilities of an economy, sector, or institutional unit. For an economy, gross assets less gross liabilities, the balancing item for a balance sheet, equals the "net worth" of the economy.

Figure A4.1. Simplified Version of Balance Sheet Accounts[1]

Assets									Liabilities and Net Worth							
Total	Rest of the world	Total economy	NPISH	House-holds	General govern-ment	Financial corpo-rations	Non-financial corpo-rations	Stocks and balancing items	Non-financial corpo-rations	Financial corpo-rations	General govern-ment	House-holds	NPISH	Total economy	Rest of the world	Total
9,922		9,922	324	2,822	1,591	144	5,041	AN **Nonfinancial assets**								
6,047		6,047	243	1,698	1,001	104	3,001	AN.1 Produced assets								
5,544		5,544	231	1,423	913	99	2,878	AN.11 Fixed assets								
231		231	2	97	47		85	AN.12 Inventories								
272		272	10	178	41	5	38	AN.13 Valuables								
3,875		3,875	81	1,124	590	40	2,040	AN.2 Nonproduced assets								
3,809		3,809	81	1,124	578	37	1,989	AN.21 Tangible nonproduced assets								
66		66			12	3	51	AN.22 Intangible nonproduced assets								
7,573	618	6,955	173	1,821	416	3,598	947	AF **Financial assets/liabilities**	1,852	3,469	712	291	122	6,446	357	6,803
770		770			80	690		AF.1 Monetary gold and SDRs[2]								
1,587	105	1,482	110	840	150		382	AF.2 Currency and deposits	40	1,281	102	10	38	1,471	116	1,587
1,388	125	1,263	25	198		950	90	AF.3 Securities other than shares	44	1,053	212	2		1,311	77	1,388
1,454	70	1,384	8	24	115	1,187	50	AF.4 Loans	897		328	169	43	1,437	17	1,454
1,409	113	1,296	22	411	12	651	200	AF.5 Shares and other equity	687	715	4			1,406	3	1,409
396	26	3,70	4	291	20	30	25	AF.6 Insurance technical reserves	12	335	19		5	371	25	396
208	45	163	1	2	20	90	50	AF.7 Financial derivatives	35	85	25	2	1	148	60	208
361	134	227	3	55	19		150	AF.8 Other accounts receivable/payable	137		22	108	35	302	59	361
								B.90 *Net worth*	4,136	273	1,295	4,352	375	10,431	261	10,692

Note: Shaded areas indicate cells that are not applicable; codes from the *1993 SNA* balance sheets are shown in the center column. Data are derived from the *1993 SNA* Table 13.1: Balance sheets—a line for financial derivatives has been added to reflect the 1999 revision to the *1993 SNA*. In addition, data differ slightly due to small errors in the *1993 SNA* table.

[1]In the *1993 SNA*, other accounts receivable/payable are accorded the code AF.7, but following the revision to the *1993 SNA* in 1999, financial derivatives are accorded the code AF.7, while other accounts receivable/payable are accorded AF.8.

[2]Monetary gold and SDRs are external assets of the total economy, but there are no counterpart liabilities for the rest of the world sector.

Figure A4.2. Balance Sheets of the Total Economy and the Rest of the World

Assets			Liabilities and Net Worth	
Rest of the world	Total economy	Stocks and balancing items	Total economy	Rest of the world
	16,877	**Assets**		
	9,922	**AN Nonfinancial assets**		
	6,047	AN.1 Produced assets		
	5,544	AN.11 Fixed assets		
	231	AN.12 Inventories		
	272	AN.13 Valuables		
	3,875	AN.2 Nonproduced assets		
	3,809	AN.21 Tangible nonproduced assets		
	66	AN.22 Intangible nonproduced assets		
618	**6,955**	**AF Financial assets/liabilities**	**6,446**	**357**
	770	AF.1 Monetary gold and SDRs		
105	1,482	AF.2 Currency and deposits	1,471	116
125	1,263	AF.3 Securities other than shares	1,311	77
70	1,384	AF.4 Loans	1,437	17
113	1,296	AF.5 Shares and other equity	1,406	3
26	370	AF.6 Insurance technical reserves	371	25
45	163	AF.7 Financial derivatives	148	60
134	227	AF.8 Other accounts receivable/payable	302	59
		B.90 Net worth	*10,431*	*261*

Note: Shaded areas indicate cells that are not applicable; codes from the *1993 SNA* balance sheets are shown in center column.

Data are derived from *1993 SNA*, Table 13.1: Balance sheets—a line for financial derivatives has been added to reflect the 1999 revision to the *1993 SNA*. Data differ slightly due to small errors in the *1993 SNA* table.

various balance sheets that shows nonfinancial as well as financial assets and liabilities by sector and instrument; for example, households hold fixed assets of 1,423 as well as shares and other equity of 411. For each financial asset/liability, the rows show total holdings and issues by sector, and the matching of asset and liability positions.[4] For each sector, the columns show financial assets owned or liabilities incurred, and also the net worth of the sector. The need for consistency among the rows and columns helps to minimize errors in the data.

10. The financial accounts in a simplified form can be derived from the second part of Figure A4.1 because financial assets and liabilities are shown for all institutional sectors involved. Net financial assets may be derived as the balancing item between financial assets and liabilities.

11. Figure A4.1 may be further simplified to show only the balance sheets of the total economy and the rest of the world sector. In Figure A4.2, the net worth of the total economy—its national wealth—equals the sum of a country's nonfinancial assets (9,922) plus its net financial claims on the rest of the world. In the balance sheet for the total economy, all financial assets and liabilities between residents are netted out in the consolidation to leave only the net financial assets position (positive or negative) on the rest of the world. For the rest of the world balance sheet, only financial assets and liabilities are shown.

A More Detailed Version of Financial Account Balance Sheets

12. Financial accounts may be expanded into three dimensions to track each instrument category, the financial claims of each sector on each other sector. By indicating who has lent to whom and with what instrument, such a matrix lends considerable analytical power to financial accounts. As with the two-dimensional approach described above, the interlocking row and column constraints of the three-dimensional matrix provide an important check on the consistency of data. This is because for each sector, each transaction involves at least, and usually, two

[4]Total financial assets and liabilities do not match because monetary gold and SDRs are financial assets that have no counterparty liability.

balance sheet changes,[5] and similarly for each instrument, each transaction involves two balance sheet changes. For example, the issue of a new debt security by a nonfinancial corporation that is purchased by a nonresident results in the following entries: the nonfinancial corporation reports the increase in *securities other than shares* liabilities, and an increase in *currency and deposit* assets; while the nonresident reports an increase in *securities other than shares* assets, and a reduction in *currency and deposits*.

13. The full three-dimensional matrix is an important analytical tool but, because of the cost and/or the conceptual complexity, relatively few countries have full flow of funds data. Figure A4.3 provides the three-dimensional financial asset matrix taken from the *1993 SNA* (Table 13.3a, page 302). As can be seen, across the top of the matrix the columns show the financial assets owned by the five mutually exclusive institutional sectors, with subsector detail for the financial corporations sector. The rows show the type of claim disaggregated by institutional sector. While a detailed breakdown of the sector of debtor is shown for *securities other than shares*, for *loans*, and for *trade credit and advances*, only a resident/nonresident breakdown is shown for *shares and other equity* and for *currency and deposits*. The matrix on financial liabilities in the *1993 SNA* (Table 13.3b, page 303), not shown here, is similar to the financial assets matrix, although the columns show the institutional sector of debtor and the rows show the institutional sector of creditor. Using both matrixes, all asset, liability, and counterpart combinations can be found. Compilers can adjust the sectors and instrument classifications in either matrix, in order to reflect national conditions and needs of users.

14. Table A4.3 is derived from the matrix in Figure A4.3 but includes only the balance sheet of the rest of the world. In comparison to the approach in Figure A4.3, financial assets and liabilities of the rest of the world account are shown by counterpart institutional sector. Compared with the *1993 SNA*, Table A4.3 includes additional counterpart sector information on the following instruments: currency, transferable deposits, other deposits, quoted shares, and nonquoted shares. In some countries this additional sectoral information is available.

[5]An example of the need for more than two entries is the settlement of a foreign currency financial derivatives contract under which the currency and deposits exchanged do not equal each other in value, with the difference recorded as a redemption of a financial derivative contract.

International Investment Position (IIP)

15. The IIP is described in Chapter 17, and so only a brief summary is provided here. The instrument classification required by the *BPM5* in respect of the IIP and the financial account of the balance of payments consists of equity instruments (which include equity securities, equity in unincorporated enterprises, and reinvested earnings), debt instruments (which include bonds and notes, money market instruments, trade credits, use of IMF credit and loans, other loans, currency and deposits, and other accounts such as arrears), and financial derivatives. Two other financial assets—monetary gold and SDRs—are identified as part of reserve assets.

16. The institutional sector of the resident creditor, for assets, and that of the resident debtor, for liabilities, is of analytical value. Accordingly, for portfolio investment, financial derivatives and other investment, the IIP distinguishes four sectors: general government, monetary authorities, banks, and other. For direct investment, however, the domestic sector is a less significant factor. For this reason, the IIP does not classify direct investment by sector. Also, because by definition reserve assets can be owned or controlled only by the monetary authorities, no sectoral classification is required for this item.

17. Classification of balance of payments transactions by institutional sector plays a significant role in linking balance of payments statistics with other statistical systems, such as the system of national accounts, money and banking statistics, and government finance statistics. While the institutional sector attribution in the IIP is not the same as in the *1993 SNA,* because of the differing analytical needs, there is a significant degree of concordance. This is described in more detail below.

Comparison Summary of the Rest of the World Balance Sheet Account and the IIP

Similarities Between the Rest of the World Balance Sheet Account and the IIP

18. As a consequence of an explicit decision by the drafters of the *1993 SNA* and *BPM5*, there is

Figure A4.3. Detailed Version of Balance Sheet Accounts

	Financial Assets											
						Financial corporations						
							Other depository corporations					
Type of Claim and Debtor	Total	Non-financial corporations	General govern-ment	NPISH	House-holds	Central bank	Deposit money corpo-rations	Other	Other financial inter-mediaries	Financial auxiliaries	Insurance corporations and pension funds	Rest of the world
1. Monetary gold and SDRs												
2. Currency and deposits												
a. Currency												
i. National												
–Residents												
–Nonresidents												
ii. Foreign												
–Residents												
b. Transferable deposits												
i. National currency												
–Residents												
–Nonresidents												
ii. Foreign currency												
–Residents												
–Nonresidents												
c. Other deposits												
i. National currency												
–Residents												
–Nonresidents												
ii. Foreign currency												
–Residents												
–Nonresidents												
3. Securities other than shares												
a. Short-term												
i. Nonfinancial corporations												
ii. Financial corporations												
iii. Central government												
iv. State and local governments												
v. Other resident sectors												
vi. Rest of the world												
b. Long-term												
i. Nonfinancial corporations												
ii. Financial corporations												
iii. Central government												
iv. State and local governments												
v. Other resident sectors												
vi. Rest of the world												
4. Loans												
a. Short-term												
i. Nonfinancial corporations												
ii. Financial corporations												
iii. Central government												
iv. State and local governments												
v. Other resident sectors												
vi. Rest of the world												
b. Long-term												
i. Nonfinancial corporations												
ii. Financial corporations												
iii. Central government												
iv. State and local governments												
v. Other resident sectors												
vi. Rest of the world												

Figure A4.3 *(concluded)*

	Financial Assets											
						Financial corporations						
							Other depository corporations					
Type of Claim and Debtor	Total	Non-financial corporations	General govern-ment	NPISH	House-holds	Central bank	Deposit money corpo-rations	Other	Other financial inter-mediaries	Financial auxiliaries	Insurance corporations and pension funds	Rest of the world
5. Shares and other equity a. Resident enterprises i. Quoted ii. Not quoted b. Nonresident enterprises i. Quoted ii. Not quoted												
6. Insurance technical reserves 6.1 Net equity of households in life insurance reserves and in pension funds 6.2 Prepayments of premiums and reserves against outstanding claims												
7. Financial Derivatives i. Nonfinancial corporations ii. Financial corporations iii. Central government iv. State and local governments v. Other resident sectors vi. Rest of the world												
8. Other accounts receivable and payable 8.1 Trade credit and advances a. Nonfinancial corporations b. Households c. Central government d. State and local governments e. Other resident sectors f. Rest of the world 8.2 Other a. Resident sectors b. Rest of the world												
Memorandum items Direct investment Equity Loans Other												

considerable homogeneity between the conceptual framework for the rest of the world balance sheet account and the IIP. The degree of homogeneity may be demonstrated by comparing their respective approaches to the coverage of financial instruments, and the application of principles such as residence, market valuation, accrual accounting, and maturity.

Coverage of Financial Instruments

19. The financial instruments recognized as financial assets and liabilities in the *1993 SNA* are identical with those recognized in *BPM5* and included in the IIP. However, the presentation of these financial assets and liabilities is not identical in the two accounts, primarily because for analytical

Table A4.3. Rest of the World Balance Sheet by Counterpart Sector

Financial Assets of Rest of World	Liabilities of Rest of World
2. Currency and deposits	2. Currency and deposits
a. Currency	a. Currency
i. National	i. National currency
ii. Foreign	i. Nonfinancial corporations
b. Transferable deposits	ii. Financial corporations
i. National currency	iii. Central government
ii. Foreign currency	iv. State and local governments
c. Other deposits	v. Other resident sectors
i. National currency	ii. Foreign currency
ii. Foreign currency	i. Nonfinancial corporations
	ii. Financial corporations
	iii. Central government
	iv. State and local governments
	v. Other resident sectors
	b. Transferable deposits
	i. National currency
	i. Nonfinancial corporations
	ii. Financial corporations
	iii. Central government
	iv. State and local governments
	v. Other resident sectors
	ii. Foreign currency
	i. Nonfinancial corporations
	ii. Financial corporations
	iii. Central government
	iv. State and local governments
	v. Other resident sectors
	c. Other deposits
	i. National currency
	i. Nonfinancial corporations
	ii. Financial corporations
	iii. Central government
	iv. State and local governments
	v. Other resident sectors
	ii. Foreign currency
	i. Nonfinancial corporations
	ii. Financial corporations
	iii. Central government
	iv. State and local governments
	v. Other resident sectors
3. Securities other than shares	3. Securities other than shares
a. Short-term	a. Short-term
i. Nonfinancial corporations	i. Nonfinancial corporations
ii. Financial corporations	ii. Financial corporations
iii. Central government	iii. Central government
iv. State and local governments	iv. State and local governments
v. Other resident sectors	v. Other resident sectors
b. Long-term	b. Long-term
i. Nonfinancial corporations	i. Nonfinancial corporations
ii. Financial corporations	ii. Financial corporations
iii. Central government	iii. Central government
iv. State and local governments	iv. State and local governments
v. Other resident sectors	v. Other resident sectors

purposes the IIP groups financial instruments into functional categories. This makes reconciliation between the two accounts difficult. Table A4.4 provides a concordance between the eight categories of financial instruments in the *1993 SNA* and their attribution in the IIP. The extent to which instruments are separately identified in the two accounts varies, as is evident from the table. However, the balance of payments transaction data provide a greater degree of detail than the

Table A4.3 ***(concluded)***

Financial Assets of Rest of World	Liabilities of Rest of World
4. Loans	4. Loans
a. Short-term	a. Short-term
i. Nonfinancial corporations	i. Nonfinancial corporations
ii. Financial corporations	ii. Financial corporations
iii. Central government	iii. Central government
iv. State and local governments	iv. State and local governments
v. Other resident sectors	v. Other resident sectors
b. Long-term	b. Long-term
i. Nonfinancial corporations	i. Nonfinancial corporations
ii. Financial corporations	ii. Financial corporations
iii. Central government	iii. Central government
iv. State and local governments	iv. State and local governments
v. Other resident sectors	v. Other resident sectors
5. Shares and other equity	5. Shares and other equity
a. Resident enterprises	i. Quoted
i. Quoted	i. Nonfinancial corporations
ii. Not quoted	ii. Financial corporations
	iii. Central government
	iv. State and local governments
	v. Other resident sectors
	ii. Not quoted
	i. Nonfinancial corporations
	ii. Financial corporations
	iii. Central government
	iv. State and local governments
	v. Other resident sectors
6. Insurance technical reserves	6. Insurance technical reserves
6.1 Net equity of nonresident households in life insurance reserves and in pension funds	6.1 Net equity of resident households in life insurance reserves and in pension funds
6.2 Prepayments of premiums and reserves against outstanding claims	6.2 Prepayments of premiums and reserves against outstanding claims
7. Financial derivatives	7. Financial derivatives
i. Nonfinancial corporations	i. Nonfinancial corporations
ii. Households	ii. Households
iii. Central government	iii. Central government
iv. State and local governments	iv. State and local governments
v. Other resident sectors	v. Other resident sectors
8. Other accounts receivable	8. Other accounts payable
8.1 Trade credit and advances	8.1 Trade credit and advances
a. Nonfinancial corporations	a. Nonfinancial corporations
b. Households	b. Households
c. Central government	c. Central government
d. State and local governments	d. State and local governments
e. Other resident sectors	e. Other resident sectors
8.2 Other	8.2 Other
a. Resident sectors	a. Nonresident sectors

IIP and so greater subdetail concordance with the *1993 SNA* flow accounts than there is between the stock measures. (See Table A4.5 of this appendix. The detailed presentation of balance of payments transactions is provided on pages 132–40 of *BPM5*.)

Monetary gold and SDRs

20. The *1993 SNA* does not separately identify monetary gold from SDRs (see Table A4.4), unlike the IIP, which separately identifies these financial assets within *reserve assets*. Gold is a component of

Table A4.4. Comparison of Breakdowns by Financial Instrument

1993 SNA Classification of Financial Instruments	*1993 SNA* Code	*BPM5* Classification of Financial Instruments	IIP Code[1]
Monetary gold and special drawing rights	**AF.1**		
		Monetary gold	5.1 (RA)
		Special drawing rights (SDRs)	5.2 (RA)
Currency and deposits	**AF.2**	**Currency and deposits**	4.3 (OI)
Currency	AF.21		5.4.1 (RA, foreign exchange)
Transferable deposits	AF.22		5.3. (RA, RPF)
Other deposits	AF.29		5.5 (part of RA, other claims)
Securities other than shares	**AF.3**	**Debt securities**	1.2 (part of DI, other capital)
Securities other than shares		Money market instruments	2.2.1 (PI, debt securities)
Short-term	AF.31	Bonds and notes	2.2.2 (PI, debt securities)
Long-term	AF.32		5.4.2.2 (RA, foreign exch.)
			5.4.2.3 (RA, foreign exch.)
			5.5 (part of RA, other claims)
Loans	**AF.4**	**Loans**	4.2.1.2 (OI)
Short-term	AF.41	Short-term loans	4.2.2.2 (OI)
Long-term	AF.42		4.2.3.2 (OI)
			4.2.4.2 (OI)
		Long-term loans	4.2.1.1 (OI)
			4.2.2.1 (OI
			4.2.3.1 (OI)
			4.2.4.1 (OI)
			5.3 (part of RA, RPF)
Shares and other equity	**AF.5**		
		Reinvested earnings	1.1 (part of DI)
		Equity capital	1.1 (part of DI)
		Equity securities	2.1 (PI)
		Equities	5.4.2.1 (RA, for. exchange)
			5.5 (part of RA, other claims)
Insurance technical reserves	**AF.6**		4.4.1.1 (part of OI, other assets/liabilities, long term)
Net equity of households in life insurance reserves and in pension funds reserves	AF.61	Net equity of households in life insurance reserves and in pension funds	4.4.2.1 (part of OI, other assets/liabilities, long term)
Net equity of households in life insurance reserves	AF.611		
Net equity of households in pension funds reserves	AF.612	Prepayments of premiums and reserves against outstanding claims	4.4.3.1 (part of OI, other assets/liabilities, long term)
Prepayments of insurance premiums and reserves for outstanding claims	F.62		4.4.4.1(part of OI, other assets/liabilities, long term)
Financial derivatives	**AF.7**	**Financial derivatives**	3 (FD)
			5.4.3 (RA)
Other accounts receivable/payable	**AF.8**		
Trade credits and advances	AF.81	Other claims on affiliated enterprises/other liabilities to affiliated enterprises	1.2 (part of DI other capital)
Other	AF.89	Other claims on direct investors/ other liabilities to direct investors	1.2 (part of DI other capital)
		Trade credits (short- and long-term)	4.1 (OI)
		Other	4.4 (part of OI, other assets/liabilities)
		Short-term	
		Long-term	
Memorandum item			
Direct investment	**AF.m**		

Note: DI, direct investment; PI, portfolio investment; FD, financial derivatives; OI, other investment; RA, reserve assets; RPF, reserve position in the Fund.

[1]In the 1999 revision to the IIP, the financial derivatives functional category is included between the portfolio and other investment functional categories. This affects the numbering of other investment and reserve assets as compared with the published *BPM5*.

reserve assets if owned by the authorities (or by others who are subject to the effective control of the authorities) and held as a reserve asset. SDRs are international reserve assets created by the IMF to supplement other reserve assets. In the rest of the world balance sheet, monetary gold and SDRs are not regarded as liabilities of the rest of the world sector, although they are regarded as external assets of the domestic economy.

Currency and deposits

21. In the *1993 SNA* category, the *currency and deposits* category is subcategorized into *currency*, *transferable deposits*, and *other deposits* (see Table A4.4). Such a subcategorization is not provided in the IIP. However, for all sectors except the monetary authorities, for whom currency and deposit data are in reserve assets, the *1993 SNA* category may be derived from 4.3 in *other investment*.

Securities other than shares

22. The *1993 SNA* subcategorizes *securities other than shares* into short- and long-term (see Table A4.4). The same principle applies to the subcategorization in the IIP, although the subcategories are entitled *money market instruments*, and *bonds and notes*. However, the IIP allocates *securities other than shares* to direct investment and reserve assets if they meet the criteria to be included in those functional categories. For direct investment, a breakdown of *securities other than shares* by subcategories is not available.

Loans

23. In both accounts, data on loans are subcategorized into short- and long-term on the basis of original maturity (see Table A4.4). Within reserve assets, loans to the IMF are included.

Shares and other equity

24. The *1993 SNA* does not subcategorize *shares and other equity,* while the IIP provides information on *reinvested earnings*, *equity capital*, *equity securities*, and *equities* (see Table A4.4). As elsewhere, the IIP attribution is primarily on a functional category basis, so if shares and other equity meet the definition of direct investment or reserve assets they are included in these functional categories. Otherwise these instruments are included in portfolio investment.

Insurance technical reserves

25. In the *1993 SNA* the *insurance technical reserves* category is subcategorized into *net equity of households in life insurance reserves and in pension funds* and *prepayments of insurance premiums and reserves for outstanding claims* (see Table A4.4). There is no subcategorization included in the IIP, and indeed the whole category is indistinguishably included in the *other assets, other investment* category in the IIP. The different approach in the two accounts reflects the relative analytical importance of this category to the domestic sectors compared with the rest of the world sector: much insurance and pension fund activity is within an economy.

Financial derivatives

26. Following the 1999 revisions, both the *1993 SNA* and the IIP show separate categories for *financial derivatives* (see Table A4.4). However, the IIP also allocates *financial derivatives* to reserve assets if they meet the criteria to be included in this functional category.

Other accounts receivable/payable

27. In the *1993 SNA*, the category *other accounts receivable or payable* has two subcategories—*trade credits and advances* and *other* (see Table A4.4). In the IIP, *trade credit* is separately identified within *other investment*, with a breakdown between short- and long-term trade credits, on an original maturity basis. The *other* subcategory from the *1993 SNA* is included within the *other assets* subcategory of *other investment,* which has a breakdown between short- and long-term. Trade credit and other assets that meet the criteria are included within direct investment.

Core Principles

28. The core principles of the *1993 SNA,* the IIP, and this *Guide* are the same. The concepts of **residence** and **valuation** are identical. A resident is an institutional unit that has its center of economic interest in the economic territory of a country, while valuation of the position data is to be at prices current on the day to which the balance sheet refers—that is, the market price.[6] Both the *1993 SNA* and

[6]The *Guide* also defines nominal value (Chapter 2) and regards this method of valuation as central to debt analysis.

BPM5 provide specific as well as general guidance on valuation.[7]

29. The *1993 SNA* and IIP, as well as this *Guide*, follow the principle of **accrual accounting** in that transactions are recorded when economic value is created, transformed, exchanged, transferred, or extinguished. Claims and liabilities are deemed to arise when there is a change in ownership (that is, when both the creditor and debtor enter the claim and liability, respectively, on their books). By contrast, under the *cash basis* of recording, transactions are recorded only when payment is made or received. Under the *due-for-payment basis* of recording, a variation of the cash basis, transactions are recorded when receipts or payments arising from the transactions fall due.

30. The *1993 SNA* and *BPM5* recommend the same method for **converting** positions denominated in **foreign currencies** into the national currency or a single foreign currency, such as U.S. dollars: the use of the market exchange rates prevailing on the date to which the balance sheet relates—the midpoint between buying and selling spot rates—is recommended. The **maturity** concept used in both the *1993 SNA* and for the IIP is that of original maturity breakdown, albeit as a secondary classification criterion. Short-term financial assets are usually defined as those with an original maturity of one year or less, and in exceptional cases two years at maximum. Long-term financial assets are defined as having an original maturity of normally more than one year and in exceptional cases more than two years at maximum.

Discrepancies Between the Rest of the World Balance Sheet Account and the IIP

31. The main discrepancies between the rest of the world balance sheet in the *1993 SNA* and the IIP are in presentation, reflecting different analytical needs. As mentioned above, the IIP gives primacy in presentation to functional categories—such as direct investment—whereas the *1993 SNA* gives primacy to instrument and sector. In addition, the *1993 SNA* recommends the presentation of a broader range of institutional sectors than is recommended by *BPM5* for the IIP. Whereas the IIP presents data for up to four institutional sectors—monetary authorities, general government, banks, and other—the *1993 SNA* recommends that data be presented for five institutional sectors in the economy. In addition, the *1993 SNA* recommends the collection of subsector detail, unlike *BPM5*. The broad reconciliation between the *1993 SNA* and *BPM5* institutional sectors is presented in Figure A4.4.

Figure A4.4. Sectoral Breakdown in *1993 SNA* and in IIP

1993 SNA	IIP
Nonfinancial corporations (S.11)	Other sectors
Central bank (S.121)	Monetary authorities
Other depository corporations (S.122)	Banks
Other financial intermediaries (except insurance corporations and pension funds) (S.123) Financial auxiliaries (S.124) Insurance corporations and pension funds (S.125)	Other sectors
General government (S.13) • Central government (S.1311) • State government (S.1312) • Local government (S.1313) • Social security funds (S.1314)	General government
Households (including noncorporations) (S.14)	Other sectors
Nonprofit institutions serving households (S.15)	Other sectors

32. As shown in the figure, two subsectors of *financial corporations* (central bank (S.121) and other depository corporations (S.122)) are related to the *BPM5* sectors *monetary authorities* and *banks*. However, the *monetary authorities* sector in the IIP includes not only the central bank but also the operations of other government institutions or commercial banks when these operations are usually attributed to the central bank. As a consequence, the delimitation of the sector *general government* in the IIP is not necessarily identical to the *1993 SNA* definition, which recommends a further breakdown into the subsectors central, state, and local government, and social security funds.[8] The other sector in the IIP comprises non-

[7]For instance, see paragraphs 14.48–14.52 of the *1993 SNA*. Chapter V of *BPM5* notes the need to apply market price proxies or equivalents in situations in which a market price in its literal sense cannot be determined (for example, the possible case of transfer pricing that significantly distorts measurement in resource transfers between affiliated enterprises).

[8]Although, as noted above, the *1993 SNA* also recommends an alternative presentation of the subcategories of general government.

Table A4.5. Correspondence of *1993 SNA* Tables with *BPM5* and IIP Components:[1] Account V—Rest of the World Account, V.III—External Accumulation Accounts

V.III.1: Capital Account

1993 SNA categories	Correspondence to balance of payments standard components [items], additional details and aggregates
Changes in assets	***Transactions in liabilities***
K.2 Acquisitions less disposals of nonproduced nonfinancial assets	Item 2.A.2 acquisition/disposal of nonproduced nonfinancial assets
B.9 Net lending (+)/net borrowing (–)	Sum of items 1. Current account balance; and 2.A. Capital account balance
Changes in liabilities and net worth	***Transactions in assets***
B.12 Current external balance	Item 1. Current account
D.9 Capital transfers receivable	Item 2.A.1 Capital transfers
D.9 Capital transfers payable	Item 2.A.1 Capital transfers
B.10.1 Changes in net worth due to saving and net capital transfers	Sum of items 1. Current account balance; and 2.A.1 Net capital transfers

V.III.2: Financial Account[2]

Changes in assets	***Transactions in liabilities***
F.1 Monetary gold and SDRs	Sum of items 2.B.5.1 monetary gold; and 2.B.5.2 special drawing rights (with sign reversed[3])
F.2 Currency and deposits	Item 2.B.4.2.3 currency and deposits
F.3 Securities other than shares	Sum of items 2.B.1.1.3.2.1 debt securities issued by direct investor; 2.B.1.2.3.2.1 debt securities issued by affiliated enterprises; 2.B.2.2.2 debt securities (part of portfolio investment)
F.4 Loans	Item 2.B.4.2.2 loans
F.5 Shares and other equity	Sum of items 2.B.1.1.1.2 equity capital: liabilities to affiliated enterprises (part of direct investment abroad); 2.B.1.2.1.2 equity capital: liabilities to direct investors (part of direct investment in the reporting economy); 2.B.1.2.2 reinvested earnings (part of direct investment in the reporting economy); and 2.B.2.2.1 equity securities (part of portfolio investment)
F.6 Insurance technical reserves	Sum of items 2.B.4.2.4.4.1.1 net equity of households in life insurance reserves and in pension funds; and 2.B.4.2.4.1.1.2 prepayments of premiums and reserves against outstanding claims
F.7 Financial derivatives	2.B.3.2 liabilities (financial derivatives)
F.8 Other accounts receivable	Sum of items 2.B.1.1.3.2.2 other liabilities of direct investors (part of direct investment abroad); 2.B.1.2.3.2.2 other liabilities to direct investors (part of direct investment in the reporting economy); 2.B.4.2.1 trade credits (part of other investment); 2.B.4.2.4 other liabilities; Minus items 2.B.4.2.4.4.1.1 net equity of households in life insurance reserves and in pension funds; and 2.B.4.2.4.4.1.2 prepayments of premiums and reserves against outstanding claims (all part of other investment)

Table A4.5 *(continued)*

V.III.2: Financial Account *(continued)*

1993 SNA categories	Correspondence to balance of payments standard components [items], additional details and aggregates
Changes in liabilities and net worth	***Transactions in assets***
F.2 Currency and deposits	Sum of items 2.B.4.1.3 currency and deposits (part of other investment); 2.B.5.3.1 deposits (part of reserve position in the Fund); 2.B.5.4.1 currency and deposits (part of foreign exchange); and 2.B.5.5.1 currency and deposits (part of other reserve claims)
F.3 Securities other than shares	Sum of items 2.B.1.1.3.1.1 debt securities issued by affiliated enterprises (part of direct investment abroad); 2.B.1.2.3.1.1 debt securities issued by direct investors (part of direct investment in the reporting economy); 2.B.2.1.2 debt securities (part of portfolio investment); 2.B.5.4.2.2 bonds and notes (part of foreign exchange); 2.B.5.4.2.3 money market instruments and financial derivatives (part of foreign exchange); and 2.B.5.5.2.2 debt securities (part of other reserve claims)
F.4 Loans	Sum of items 2.B.4.1.2 loans (part of other investment); and 2.B.5.3.2 loans (part of reserve position in the Fund)
F.5 Shares and other equity	Sum of items 2.B.1.1.1.1 equity capital: claims on affiliated enterprises (part of direct investment abroad); 2.B.1.1.2 reinvested earnings (part of direct investment abroad); 2.B.1.2.1.1 equity capital: claims on direct investors (part of direct investment in the reporting economy); 2.B.2.1.1 equity securities (part of portfolio investment); and 2.B.5.4.2.1 and 2.B.5.5.2.1 equities (part of reserve assets, foreign exchange, and other claims)
F.6 Insurance technical reserves	Sum of items 2.B.4.1.4.4.1.1 net equity of households in life insurance reserves and in pension funds; 2.B.4.1.4.1.1.1; 2.B.4.1.4.2.1.1; 2.B.4.1.4.3.1.1; and 2.B.4.1.4.4.1.2 prepayments of premiums and reserves against outstanding claims (all part of other investment)
F.7 Financial derivatives	Sum of items 2.B.3.1 assets (financial derivatives), and 2.B.5.4.3 financial derivatives (part of foreign exchange)
F.8 Other accounts payable	Sum of items 2.B.1.1.3.1.2 other claims on affiliated enterprises (part of direct investment abroad); 2.B.1.2.3.1.2 other claims on direct investors (part of direct investment in the reporting economy); 2.B.4.1.1 trade credits (part of other investment); 2.B.4.1.4 other assets; Minus tems 2.B.4.1.4.4.1.1 net equity of households in life insurance reserves and in pension funds; 2.B.4.1.4.1.1.1; 2.B.4.1.4.2.1.1; 2.B.4.1.4.3.1.1; and 2.B.4.1.4.4.1.2 prepayments of premiums and reserves against outstanding claims (all part of other investment)
B.9 Net lending (+)/net borrowing (–)	

Table A4.5 ***(concluded)***

V.III.3: Other Changes in Assets Accounts, V.III.3.1: Other Changes in Volume of Assets Account

1993 SNA categories	Correspondence to balance of payments standard components [items], additional details and aggregates
Changes in assets	***Changes in liabilities***
K.7 Catastrophic losses	Catastrophic losses (part of other adjustments)
K.8 Uncompensated seizures	Uncompensated seizures (part of other adjustments)
K.10 Other volume changes in financial assets and liabilities, n.e.c.	Other volume changes (part of other adjustments)
K.12 Changes in classifications and structure	Change in classifications and structure (part of other adjustments)
Changes in liabilities and net worth	***Changes in assets***
K.7 Catastrophic losses	Catastrophic losses (part of other adjustments)
K.8 Uncompensated seizures	Uncompensated seizures (part of other adjustments)
K.10 Other volume changes in financial assets and liabilities, n.e.c.	Other volume changes (part of other adjustments)
K.12 Changes in classifications and structure	Change in classifications and structure (part of other adjustments)
B.10.2 Changes in net worth due to other changes in volume of assets	
Changes in assets	***Changes in liabilities***
K.11 Nominal holding gains/losses in financial assets	Sum of entries in the columns for price and exchange rate changes
K.11.1 Neutral holding gains/losses in financial assets	Sum of entries in the columns for neutral holding gains/losses
K.11.2 Real holding gains/losses in financial assets	Sum of entries in the columns for real holding gains/losses
Changes in liabilities and net worth	***Changes in assets***
K.11 Nominal holding gains/losses in liabilities	Sum of entries in the columns for price and exchange rate changes
K.11.1 Neutral holding gains/losses in liabilities	Sum of entries in the columns for neutral holding gains/losses
K.11.2 Real holding gains/losses in liabilities	Sum of entries in the columns for real holding gains/losses
B.10.3 Changes in net worth due to nominal holding gains/losses	Price and exchange rate changes in assets less price and exchange rate changes in liabilities
B.10.31 Changes in net worth due to neutral holding gains/losses	Neutral holding gains/losses in assets less neutral holding gains/losses in liabilities
B.10.32 Changes in net worth due to real holding gains/losses	Real holding gains/losses in assets less real holding gains/losses in liabilities

[1]The assets of the rest of the world sector in the *1993 SNA* correspond with the liabilities in the balance of payments and the IIP, and vice versa.

[2]The detailed presentation of balance of payments transactions that is used for this comparison with the *1993 SNA* financial instrument categories is provided on pp. 132–40 of *BPM5*. Due to the introduction of financial derivatives as a separate category in the *1993 SNA* and a separate functional category in *BPM5*, some series have been renumbered since the publication of these manuals.

[3]The domestic sector has a "claim" on the rest of the world sector.

financial corporations (S.11), some subsectors of financial corporations such as other financial intermediaries (S.123), financial auxiliaries (S.124), as well as insurance corporations and pension funds (S.125), households (S.14), and NPISH (S.15).

Detailed Examination of the Classification Linkages Among the Rest of the World Account, the Balance of Payments Accounts, and the IIP

33. Although harmonization in concepts has been attained between both systems, differences in presentation reflect differences in analytical requirements, the relative quantitative significance of some items in international transactions, and constraints imposed by the internal structures of the respective accounts. Nonetheless, bridges can be constructed to derive relevant national accounting flows and stocks from balance of payments accounts and the international investment position.

34. In terms of transactions, the *1993 SNA* distinguishes the following accounts in respect of the rest of the world account of goods and services:

- Account V.I: External account of goods and services (page 316 of the *1993 SNA*);
- Account V.II: External account of primary incomes and current transfers (page 316);

Table A4.6. Correspondence of *1993 SNA* Tables with *BPM5* and IIP Components: Account V—Rest of the World Account, V.IV—External Assets and Liabilities Account

1993 SNA categories	Correspondence to international investment position standard components and additional details
V.IV.1: Opening Balance Sheet	
AF Financial assets	Sum of items B.1.1.2 liabilities (equity capital and reinvested earnings) to direct investors (part of direct investment in the reporting economy); B.1.2.2 liabilities (other capital) to direct investors (part of direct investment in the reporting economy); A.1.1.2 liabilities (equity capital and reinvested earnings) to affiliated enterprises (part of direct investment abroad); A.1.2.2 liabilities (other capital) to affiliated enterprises (part of direct investment abroad); B.2 portfolio investment; and B.3 financial derivatives; and B.4 other investment.
AF Liabilities	Sum of items A.1.1.1 claims (equity capital and reinvested earnings) on affiliated enterprises (part of direct investment abroad); A.1.2.1 claims (other capital) on affiliated enterprises (part of direct investment abroad); B.1.1.1 claims (equity capital and reinvested earnings) (part of direct investment in the reporting economy); B.1.2.1 claims (other capital) on direct investors (part of direct investment in the reporting economy); A.2 portfolio investment; A.3 financial derivatives; and A.4 other investment; and A.5 reserve assets.[1]
B.90 Net worth	
V.IV.2: Changes in Balance Sheet	
AF Total changes in financial assets	Sum of transactions, price and exchange rate changes, and other adjustments in respect of the corresponding international investment position items identified in account V.IV.1.
AF Total changes in liabilities	Sum of transactions, price and exchange rate changes, and other adjustments in respect of the corresponding international investment position items identified in account V.IV.1.
B.10 Changes in net worth, total	Total changes in assets – total changes in liabilities.
V.IV.3: Closing Balance Sheet	
AF Financial assets	Sum of end of period values of corresponding items in the international investment position and identified in Account V.IV.1.
AF Liabilities	Sum of end of period values of corresponding items in the international investment position and identified in Account V.IV.1.
B.90 Net worth	

[1]Monetary gold and SDRs are components of reserve assets that have no counterpart liability in the rest of the world sector of the national accounts.

- Account V.III.1: Capital account (page 316) and V.III.2: Financial account (page 317), which are components of V.III: External accumulation accounts (page 316).

In *BPM5*, the transactions reflected in Accounts V.I and V.II are those in the current account component of the balance of payments accounts, while those reflected in Account V.III.1 are contained in the capital account component of the capital and financial account of the balance of payments. The flows reflected in V.III.2 are shown in the financial account component of the capital and financial account. Account V.III.3.1: Other changes in volume of assets (page 317) and Account V.III.3.2: Revaluation account (page 317) are included within the IIP statement in *BPM5*, in order to reconcile the transactions between reporting dates with the change in positions. Thus, Account V.III.3.1 corresponds to the column for "other adjustments" in

the IIP statement, while Account V.III.3.2 corresponds to the columns for "price changes" and "exchange rate changes" in the IIP statement. Account V.IV: External assets and liabilities account (page 318) is equivalent to the IIP statement in *BPM5*.

35. Tables A4.5 and A4.6 (on preceeding page) provide reconciliation between the categories shown in the relevant capital and financial accounts for the external sector of the *1993 SNA* and corresponding items in balance of payments accounts and the IIP. The major elements of the *1993 SNA* capital account of the external accumulation accounts (Table A4.5, Account V.III.1) are identical with the capital account component of the capital and financial account of the balance of payments. Although the balancing item, net lending/net borrowing, in the capital account of the *1993 SNA* is not explicitly identified in the balance of payments, it nonetheless can be derived by adding the current account balance and the balance of transactions reflected in the capital account of *BPM5*.

36. Coverage of the *1993 SNA* financial account (Table A4.5, Account V.III.2) is identical with the coverage of the financial account of the capital and financial account in the balance of payments, although the level of detail is different. As noted above, in the *1993 SNA* the primary focus is on financial instruments, whereas in the balance of payments the primary focus is on functional categorization (that is, direct investment, portfolio investment, financial derivatives, other investment, and reserve assets). In addition to identifying types of financial instruments (insurance technical reserves being an exception), the balance of payments includes an abbreviated sector breakdown (that is, monetary authorities, general government, banks, and other). Furthermore, to conform with the *1993 SNA*, *BPM5* states that entries in the credit and debit sides of the financial account of the balance of payments are recorded, in principle, on a net basis (that is, increases less decreases in assets or liabilities). However, gross recording is recommended as supplementary information, such as in the case of drawings and repayments on long-term loans.

Appendix V. Heavily Indebted Poor Countries (HIPC) Initiative and Debt Sustainability Analysis

1. The Heavily Indebted Poor Countries (HIPC) Initiative is a major initiative of consequence to the monitoring of external debt position. The objective of this Initiative is to reduce external debt positions of some low-income countries to sustainable levels—that is, to levels that enable them to meet their current and future external debt-service obligations in full, without recourse to debt rescheduling or accumulation of arrears, and without compromising growth. Among other things, this requires accurate measurement of the external debt position. In this appendix, the HIPC Initiative is described, along with Debt Sustainability Analysis (DSA), a building block of the HIPC Initiative.

HIPC Initiative

Origin and Description of the HIPC Initiative

2. For a number of low-income countries, it was recognized in the second half of the 1990s, by official creditors in particular, that the external debt situation was becoming extremely difficult. For such countries, even full use of traditional mechanisms of rescheduling and debt reduction—together with continued provision of concessional financing and pursuit of sound economic policies—would not be sufficient to attain sustainable external debt levels within a reasonable period of time and without additional external support. The HIPC Initiative is a comprehensive, integrated, and coordinated framework developed jointly by the IMF and the World Bank to address these external debt problems of the HIPCs. The framework was adopted in September 1996, through its endorsement by the Interim and Development Committees of the IMF and World Bank. Following a comprehensive review launched in early 1999, the Initiative was enhanced in September 1999 to provide faster, deeper, and broader debt relief, and to strengthen the links between debt relief, poverty reduction, and social policies.

3. The Initiative is designed to enable HIPCs that have a strong track record of economic adjustment and reform to achieve a sustainable debt position over the medium term. Central to the Initiative are the country's continued efforts toward macroeconomic and structural adjustment and social reforms, with an emphasis on poverty reduction. Thus, all countries requesting HIPC Initiative assistance must (1) have adopted a Poverty Reduction Strategy Paper (PRSP) through a broad-based participatory process, by the decision point (see below), and (2) have made progress in implementing this strategy for at least one year by the completion point (see below).[1] These efforts are complemented by a commitment from the international financial community to tackle the country's external debt problem in a comprehensive and coordinated fashion. Indeed, the Initiative requires the participation of all creditors—bilateral, multilateral, and commercial.

Eligibility Criteria and the Structure of the HIPC Initiative

4. To receive assistance under the HIPC Initiative, countries need to be both eligible and face unsustainable external debt positions. To be eligible, a country needs to have satisfied a set of criteria. Specifically, it must:

- Be eligible for concessional assistance from the IMF and World Bank;
- Face an unsustainable debt burden, beyond existing, traditional debt-relief mechanisms;[2] and

[1]On a transitional basis, given the time country authorities need to prepare a participatory PRSP, countries can reach their decision points based on an interim PRSP (I-PRSP), which sets out the government's commitment to and plans for developing a PRSP.

[2]Such as a Paris Club stock-of-debt operation on a Naples terms 67 percent present value reduction with at least comparable action from bilateral creditors. Table 8.2 in Chapter 8 sets out the evolution of Paris Club rescheduling terms.

- Establish a track record of reform and sound policies through IMF- and World Bank-supported programs.

5. The sustainability of the external debt position is determined by comparing the outcome of a comprehensive loan-by-loan DSA, agreed both with the authorities and creditors, with the HIPC targets. At the time of writing, these targets are set at 150 percent for the present value of the ratio of debt to exports, and 15 percent for the ratio of debt service to exports. For very open economies (with an exports-to-GDP ratio of at least 30 percent) that have a heavy fiscal burden of debt despite strong efforts to generate revenue (indicated by a ratio of fiscal revenue to GDP of at least 15 percent), the present value of debt-to-exports target can be lower than 150 percent and is set so as to achieve a 250 percent ratio of the present value of debt to fiscal revenue at the decision point.[3]

6. The IMF and World Bank Executive Boards determine need, and commit assistance, at the decision point. Those institutions and some other creditors also start delivering part of their assistance between the decision and completion points (interim relief).[4] Assistance is provided, irrevocably by all creditors, at (or before) the completion point—subject, as mentioned above, to the country implementing a set of key, predefined structural reforms.[5] Thus, there is an incentive for countries to implement reforms quickly, and so develop ownership over the timetable. Figure A5.1 sets out the process in diagrammatical form.

Calculations of Overall Assistance

7. Assistance under the HIPC Initiative is defined as the present value reduction required to lower external debt at the decision point to the Initiative's targets. Total assistance is defined as assistance at the completion point plus the action provided during the interim period. The external debt position calculation under the HIPC Initiative (or net present value, NPV, calculation of external debt as it is described in HIPC terminology)[6] is the sum of all future debt-service obligations (interest and principal) on existing debt on a loan-by-loan basis, discounted at the market interest rate (the Commercial Interest Reference Rate, CIRR, from the OECD). So for concessional lending, the calculation results in a present value of debt less than its nominal value, because the interest rate on the loan is less than the market rate. The calculation of the external debt position at the decision point uses the latest actual end-of-period data available, measured after assuming a hypothetical Paris Club stock-of-debt operation on Naples terms (67 percent reduction on eligible debt) and comparable treatment on other official bilateral and commercial claims.

Burden-Sharing Among Creditors and Delivery of Assistance

8. One of the Initiative's guiding principles is broad and equitable participation of all creditors (multilateral, official bilateral, and commercial) in providing assistance sufficient for the country to achieve debt sustainability. For the Paris Club, this generally involves a stock-of-debt operation with a reduction of up to 90 percent in the present value of eligible claims. The country is required to seek at least comparable treatment from its other official bilateral and commercial creditors.

9. Multilateral creditors take action proportional to bilateral creditors to reduce the present value of their claims on the country. Each multilateral institution chooses the vehicle to deliver its share of assistance (derived in proportion to its share in the present value of multilateral claims at the decision point). The IMF's contribution is made in the form of grants financed from Poverty Reduction and Growth Facility (PRGF) resources[7] and is used only to meet debt-

[3]The export denominator is derived as the "backward-looking" three-year average of exports of goods and services (*BPM5* definition) over the latest actual data that will be available at the decision point. The fiscal revenue denominator, if used, is the latest actual end-of-period figure, and is defined as central government revenue (excluding grants).

[4]Bilateral and commercial creditors are generally expected to reschedule obligations coming due. There are limits to the maximum assistance that the IMF and World Bank can provide during the interim period.

[5]A number of key elements or triggers are identified that would adequately represent overall progress in macroeconomic, structural, and social areas, and that would eventually translate into durable growth, debt sustainability, and poverty reduction.

[6]While the term NPV is commonly used, frequently it would be more accurate to describe the calculation as present value—discounting future interest and principal payments by an interest rate—and this is the approach taken in the *Guide*.

[7]The PRGF is available to those countries that are facing protracted balance of payments problems and are eligible to borrow on concessional terms under the International Development Association (IDA). Previous to November 1999, the PRGF was known as the Enhanced Structural Adjustment Facility (ESAF).

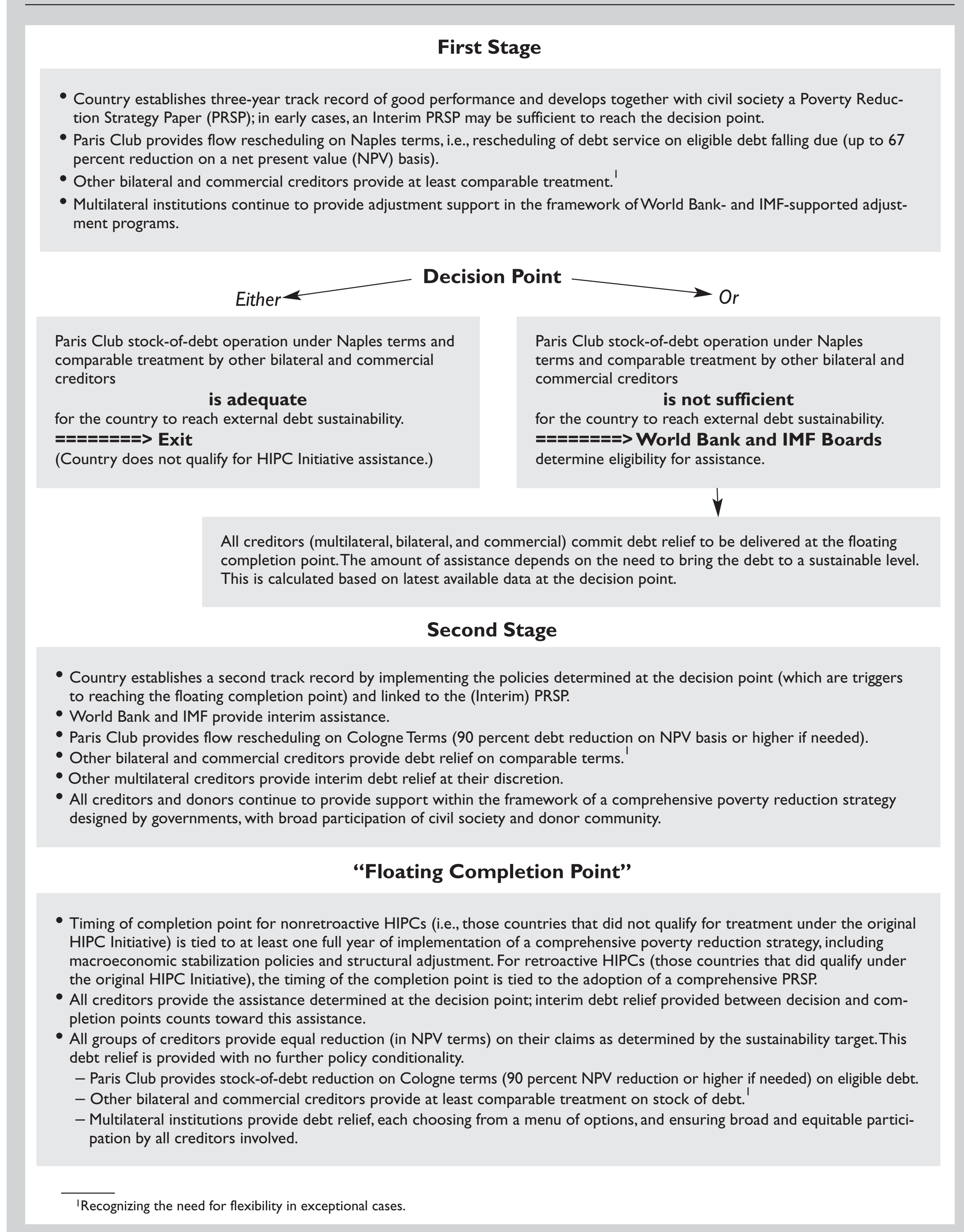


Figure A5.1. Enhanced HIPC Initiative Flow Chart

service obligations to the IMF. The European Union provides grants.

10. The World Bank is committed to take action after the decision point—through the selective use of IDA grants and allocations—and at the completion point. The principal vehicle for the Bank's participation, together with some other multilateral creditors, is the HIPC Trust Fund. This Trust Fund provides relief to eligible countries on debt owed to participating multilaterals and is administered by IDA, with contributions from participating multilateral creditors and bilateral donors. To provide relief on debt owed to IDA, the Bank made transfers from its IBRD net income and surplus to the HIPC Trust Fund.

11. The debt contracted with multilateral and bilateral creditors, covered by the HIPC Initiative, is limited to public and publicly guaranteed debt—that is, external obligations of a public debtor including national government and autonomous public bodies and external obligations of a private debtor that are guaranteed for repayment by a public entity. The debt comprises:

- All medium- and long-term government and government-guaranteed external debt;
- Short-term debt[8] only if it has long been in arrears;
- Debt of public enterprises defined as "at least 50 percent owned by the government"; and
- Debt of public enterprises being privatized, if the debt remains with the government.

Treatment of Arrears

12. Countries seeking assistance under the HIPC Initiative need to work toward elimination or reduction of existing arrears and the nonaccumulation of new external payments arrears. All arrears to multilateral creditors are expected to be cleared, or included in an agreement on a schedule for their clearance before the decision point is reached. However, clearance of such arrears needs to be consistent with a country's financing constraint. In addition, concessionality that is granted in arrears-clearance operations by multilateral banks can count toward assistance required under the Initiative, on a case-by-case basis.

[8]Debt that has an original maturity of one year or less.

Debt Sustainability Analysis (DSA)

13. DSAs are central to the work of the HIPC Initiative. DSAs are prepared, on a tripartite basis, jointly by the country authorities, the World Bank, and the IMF and, where appropriate, by the relevant regional development banks, such as the African Development Bank and the Inter-American Development Bank. Figure A5.2 sets out the DSA process in diagrammatical form.

DSA Process

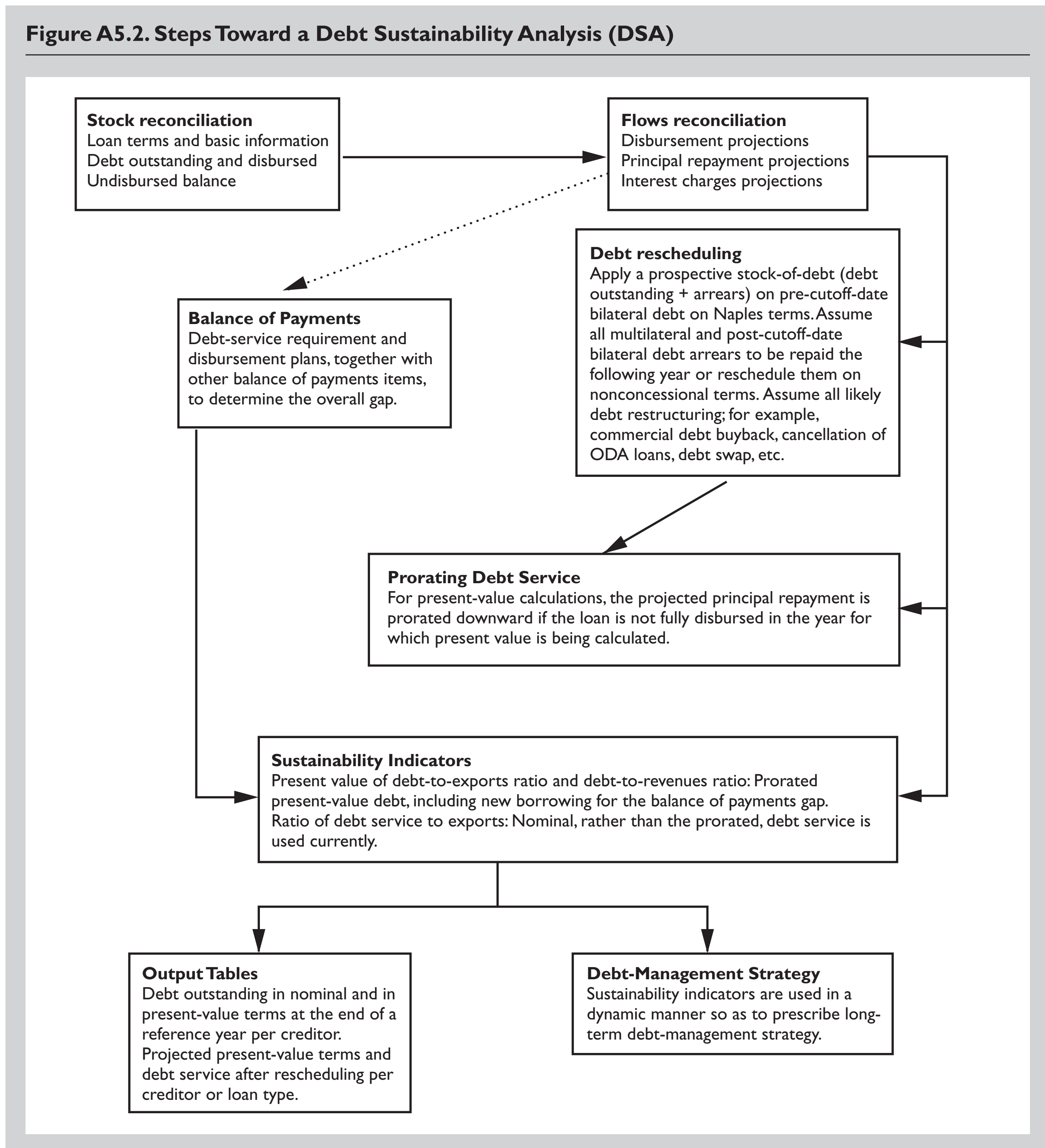
14. In preparation for the decision point discussion, a DSA is carried out to determine the current external debt situation of the country. This is essentially a medium-term balance of payments projection that assesses the debt burden of the country and its capacity to service those obligations. If external debt ratios for that country fall above applicable targets after application of traditional debt-relief mechanisms, HIPC Initiative assistance is considered.

15. The DSA is undertaken on the basis of debt stock and flow projections. All the information needs to be obtained on a loan-by-loan basis, disaggregated by creditor and currency. The stock of debt is the amount outstanding at the end of the latest available fiscal or calendar year, depending on whether the country operated on a fiscal or calendar year basis. Projections of financial flows consist of expected amortization payments, disbursements on existing debt, and new loans.

16. Countries seeking assistance under the HIPC Initiative are expected to fully reconcile all debt data on a loan-by-loan basis with the creditor billing records before the decision point.[9] The reconciliation process refers to the position and flows. If a loan is amortized according to its original schedule (if there are no adjustments such as rescheduling, forgiveness, cancellations, supplemental commitments, arrears, or prepayments), the periodic flows depend mainly on the original terms of the loan. Any adjustments to the loan amount, such as write-offs or rescheduling, have to be taken into account, so that a reconciled debt service is agreed (and, by extension, the present value of the debt). The information needed by a HIPC country compiler is set out in Table A5.1.

[9]The preliminary HIPC document data might be on the basis of partially reconciled data.

Figure A5.2. Steps Toward a Debt Sustainability Analysis (DSA)



17. The consistency of stock and flow data on existing debt needs to be assessed. Simple equations can help the data compiler to complete this task, such as:

- The sum of future repayments of loan principal equals the outstanding debt (assuming no accrual of interest costs);
- The sum of future disbursements of loan principal equals the undisbursed balance; and
- For interest projections, egregious errors could be checked by calculating the implied interest rate (interest t/stock of debt $t - 1$) for a reference year and comparing it to the interest rate recorded in the original terms. For each loan there is a declining

Table A5.1. Data Needed by a HIPC Country Compiler

General information
— Debtor
— Debtor type (central bank, public enterprises, etc.)
— Creditor
— Creditor type (official, bilateral, commercial banks)
— Debtor loan identification
— Creditor loan identification
— Project title
— Loan type (supplier's credit, export credit, etc.)
— Date of signature
— Committed amount and currency of the loan
— Disbursed amount
— First and last date of amortization
— Grace period
— Maturity
— Interest rate and other charges (fixed or variable interest rate)
— Penalty on arrears
— Repayment schedule (equal installments, annuity, etc.)
— Cutoff date
— Grant element
— Identification of ODA loans

At the end of a period
— Stock of debt
— Arrears on principal (on a loan-by-loan basis)
— Arrears on interest
— Exchange rates at the end-of-period and average exchange rate of the year
— Average six-month CIRR rates

Disbursements
— On "pipeline" debt
— New debt

Macroeconomic data
— Gross domestic product
— Balance of payments
— Government finance statistics

Note: ODA, official development assistance; CIRR, Commercial Interest Reference Rate (OECD).

interest charge as the years progress and the debt stock is being reduced with each amortization.

18. Regarding new loans, given certain underlying assumptions, the expected financing gap on the balance of payments is projected. This is the baseline scenario. Assumptions have to be made about how the gap is to be filled—by grants, concessional loans, or commercial borrowing. The terms of any gap-filling loans can be assumed to be the same as the assumptions on new disbursement terms, or they can vary according to the assessment of willingness to fill the financing gap—if this is possible to assess. For instance, new borrowing to finance the gap can be introduced into the DSA framework as two separate loans for each year. The first might be assumed to be available on IDA terms, while the remainder is secured at less concessional terms, but still at a concessional rate.

19. Interest charges on new borrowing enter the debt-service stream six months to one year after they are assumed to be committed, and the repayments of the principal become due after the grace period ended. So, for each year, the balance of payments financing gap is established, with any resultant new borrowing being fed back into DSA as a new loan. Hence, the balance of payments and the DSA data are obtained interactively over the projection period, and the new debt-service flows taken into account in calculating the present value[10] and debt-service indicators that are presented in the decision point document. This document is the basis for the Bank and IMF Boards' decisions on the eligibility and amount of assistance for the country.

20. Furthermore, sensitivity analysis is undertaken—the decision point document includes the results of alternative macroeconomic scenarios, thus providing a quantitative assessment of the impact of downside risks of the baseline balance of payments scenario. Modified assumptions are applied to external sector variables, such as international prices and trade volumes, and availability and terms of the financing items in the balance of payments. A modification to an assumption may have numerous direct and secondary effects on the balance of payments projections and the whole macroframework. In principle there are two ways for reflecting the impact of the envisaged shock. The first would be to capture only the immediate direct effect of any adverse shock on the balance of payments, which is reflected in lower credit entries or higher debit entries along with a higher additional financing gap. The additional financing gap would then be covered by new borrowing, which in turn would raise the debt ratios. This is normally the preferred approach for HIPC alternative scenarios.

21. The alternative approach takes into account secondary effects, such as slower economic growth, which would typically dampen the initial increase in the financing gap. For example, a significant short-

[10]Debt service on new borrowing did not affect the external debt position in the reference year used for decision point calculation of assistance.

fall in coffee exports would, in the first instance, cause a higher balance of payments financing gap. In addition, however, it would also lead to slower GDP growth and lower import demand, which would partially compensate for the initial increase in the financing gap. However, this approach is applied only in cases where the first approach implies highly unrealistic outcomes.

Interest Rate and Currency Assumptions Under the DSA

22. The currency-specific CIRR discount rates used in DSAs to calculate the present value of external debt are averages over the six-month period up to the reference date. For those currencies for which no CIRR rates are available but that are pegged to another currency, such as the U.S. dollar, the CIRR for the latter is used. In the absence of an exchange rate arrangement, as well as for the units of account used by various multilateral institutions, the SDR rate should be applied.

23. The present value of external debt is converted from its currency components into U.S. dollars using the actual end-of-period exchange rates—the same date as the reference date for the gross external debt position. These rates are applied to base-year calculations, as well as to projections. The conversion of debt-service payments in the numerator of the debt-service ratio is performed on the basis of average exchange rates using actual rates for the past and projections for the future taken from the IMF's *World Economic Outlook*.

24. For the purpose of determining a country's eligibility for the fiscal/openness criteria, central government revenue and GDP used in the revenue-to-GDP ratio (the three-year average) at the decision point are converted into U.S. dollars on the basis of actual average exchange rates in each of the three years. Projected central government revenue used to determine the NPV of the debt-to-revenue ratio at the completion point are converted by applying the latest end-of-period exchange rate available at the decision point.

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