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March 21, 2022

## **POVERTY REDUCTION AND GROWTH—GUIDANCE NOTE ON NEW ENHANCED SAFEGUARDS FOR DEBT SUSTAINABILITY AND CAPACITY TO REPAY**

*In March and July 2021, the IMF Executive Board endorsed new enhanced safeguards for debt sustainability and capacity to repay that would apply to requests for new Poverty Reduction and Growth Trust (PRGT) arrangements or augmentations above certain access thresholds and for countries at high risk of debt distress or in debt distress. The safeguards were introduced in the context of increases in PRGT access limits, in recognition of the need for stronger safeguards to mitigate risks associated with higher Fund lending. This note provides guidance on how to implement the new enhanced safeguards.*

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## Acronyms and Abbreviations

ADB	Asian Development Bank
AfDB	African Development Bank
BoP	Balance of Payments
CtR	Capacity to Repay
DLP	Debt Limits Policy
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
EA	Exceptional Access
ES	Enhanced Safeguards
FCS	Fragile and Conflict-Affected States
FIN	Finance Department
GDP	Gross Domestic Product
GRA	General Resource Account
GIR	Gross International Reserves
HAP	High Access Procedures
HIPC	Heavily Indebted Poor Country
IADB	Inter-American Development Bank
IFI	International Financial Institution
IMF	International Monetary Fund
LIC	Low-Income Country
LNG	Liquefied Natural Gas
MDB	Multilateral Development Bank
MDRI	Multilateral Debt Relief Initiative
PCS	Preferred Creditor Status
PPG	Public and Publicly Guaranteed
PRGT	Poverty Reduction and Growth Trust
PS-HCC	Policy Safeguards for High Combined Credit
PV	Present Value
RCF	Rapid Credit Facility
RFI	Rapid Financing Instrument
SBA	Stand-By Arrangement
SCF	Standby-Credit Facility
SPVs	Special Purpose Vehicles
UCT	Upper Credit Tranche
WB	World Bank

# ARCHITECTURE OF THE FUND'S DEBT SUSTAINABILITY AND CAPACITY TO REPAY SAFEGUARDS

**1. In March 2021 the Fund introduced new enhanced safeguards (ES) that apply to requests for new Poverty Reduction and Growth Trust (PRGT) arrangements or augmentations.**<sup>1</sup> The ES were further elaborated and endorsed by the Board in July 2021, in the context of the increase in normal access limits and other reforms to the PRGT.<sup>2</sup> They are intended to manage and mitigate credit risk to the Fund by strengthening scrutiny of debt sustainability and capacity to repay the Fund (CtR).

**2. For cases where the ES apply, program documents must include:**<sup>3</sup>

- a granular discussion of the composition and evolution of debt (ES1A);
- an enhanced CtR analysis informed by cross-country comparisons of metrics of Fund exposure (ES1B); and
- discussion of the explicit program objective to reduce debt vulnerabilities (ES2).

**3. The ES are required in the following circumstances:**

- Where requests for new PRGT arrangements or augmentations entail access above 100 percent of quota annually or 300 percent of quota cumulatively (normal access limits before the July 2021 increase to 145/435 percent of quota), ES1A and ES1B apply.
- Where countries requesting new PRGT arrangements or augmentations are assessed at high risk of, or in, overall debt distress, all ES safeguards apply (ES1A, ES1B, and ES2), except that for in cases of exceptional PRGT access or high combined credit, ES2 does not apply (see below).<sup>4</sup>
- The ES do not apply to program reviews, emergency financing, or non-financial instruments.

**4. The ES complements the Fund's multi-layered framework for managing credit risk and adds to the existing tools for addressing debt vulnerabilities and capacity to repay the Fund.**

<sup>1</sup> See *Temporary Extensions and Modifications of Access Limits in the Fund's Lending Facilities*, March 2021.

<sup>2</sup> See *Fund Concessional Financial Support for Low-Income Countries—Responding to the Pandemic (Annex VI)*, July 2021.

<sup>3</sup> This requirement involves the preparation of tables/charts and a brief discussion to satisfy ES1A and ES1B, and a discussion for ES2. ES1A, and ES2 can be presented in a separate Annex (with a brief reference in the staff report discussion of program risks) while ES1B can be included in the usual section on CtR in the program modalities section of the staff report.

<sup>4</sup> It is possible for a country to be rated in distress due to historical arrears (if they cannot be deemed away based on representative Paris Club agreement or the application of the three criteria of the Lending into Official Arrears Policy). In the rare cases where resolving these long-standing arrears would be sufficient by itself to change the risk rating from "in distress" to low/moderate risk, it may not be necessary to apply ES.

The framework also includes Exceptional Access Policy (EA),<sup>5</sup> Policy Safeguards for High Combined Credit (PS-HCC),<sup>6</sup> and High Access Procedures (HAP).<sup>7</sup> These other elements continue to apply alongside the ES. Specifically:

- EA and PS-HCC.
  - A financing request that triggers the ES may also trigger the EA and/or PS-HCC safeguards (applicable when combined PRGT and GRA (General Resource Account) access exceeds 145 percent of quota annually/435 percent cumulatively). In such cases, ES1A and ES1B will apply at the time of the program request, alongside the EA/PS-HCC. ES2 will not apply since the EA and PS-HCC policies automatically satisfy ES2 given that the debt sustainability requirement under EA2/PS-HCC2 is more stringent (reducing the risk of overall debt distress to low or moderate).
  - As noted above, the ES will not apply to RCF/RFI (Rapid Credit Facility/Rapid Financing Instrument) requests or to regular program reviews, unlike the EA and PS-HCC.
  - The ES do not affect documentation or procedural requirements under EA and PS-HCC. However, teams may wish to include additional information required under ES such as the deeper discussion of CtR (ES1B) in the staff note for the informal EA Board meeting.
- HAP
  - A financing request that triggers the ES may also trigger the HAP safeguards (when a country's PRGT access exceeds 240 percent of quota over 36 months (flow trigger) or credit outstanding to the PRGT exceeds 300 percent of quota at any point during the program (stock trigger). In such cases, the ES will apply alongside the HAP.
  - The ES do not affect documentation or procedural requirements under the HAP. However, teams may wish to include additional information required under ES such as the deeper discussion of CtR (ES1B) as an analytical input for the staff note for the informal HAP Board meeting.

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<sup>5</sup> See Fund *Concessional Financial Support for LICs—Responding to the Pandemic (see Annex II)*, July 2021.

<sup>6</sup> See *Policy Safeguards for Countries Seeking Access to Fund Financial Support that would Lead to High Levels of Combined GRA-PRGT Exposure*, September 2020.

<sup>7</sup> See Fund *Concessional Financial Support for LICs—Responding to the Pandemic (see Box 2)*, July 2021.

### Application of Multi-layered Architecture on Debt and Capacity to Repay Safeguards

	ES		HAP	EA
	ES1A/1B	ES2		
<b>Financing arrangements (including precautionary arrangements)</b>				
I. New request (including augmentations)				
A. Access is at or below 100/300 (Annual/Cumulative).				
1. Low or Moderate risk of debt distress	No	No	Maybe 1/	No
2. High risk of debt distress or in debt distress	Yes	Yes	Maybe	No
B. Access is above 100/300 and at or below 145/435.				
1. Low or Moderate risk of debt distress	Yes	No	Maybe 2/	No
2. High risk of debt distress or in debt distress	Yes	Yes	Maybe	No
C. Access is above 145/435.				
1. Low or Moderate risk of debt distress	Yes	No	Yes	Yes
2. High risk of debt distress or in debt distress	Yes	No	Yes	Yes
II. Reviews	No	No	No	Yes
<b>Emergency Financing</b>	No	No	Yes	Yes
<b>Non-financial instrument</b>	No	No	No	No

1/ For example, a request for a 3-year ECF arrangement by a country at L or M risk of debt distress with no PRGT credit outstanding for 270 percent of quota that is equally disbursed per year is subject to HAP, but not subject to ES.

2/ For example, a request for a 3-year ECF arrangement by a country at L or M risk of debt distress with no PRGT credit outstanding for 210 percent of quota that is frontloaded with 110 percent of quota in the first year followed by 50 percent of quota per annum in following years is subject to ES1A/1B, but not subject to HAP.

## ES1A: COMPOSITION AND EVOLUTION OF DEBT

5. **ES1A: Program documents are expected to include a discussion of the structure of public external debt and its projected evolution over time, focusing on debt owed to the Fund and other multilateral creditors,<sup>8</sup> which may enjoy de facto senior status, and collateralized debt, which may be more difficult to restructure.** The discussion should be informed by a table showing the breakdown and ratios of debt composition as illustrated in the template in Table 1.<sup>9</sup> The breakdown on the current debt composition is already required as part of the Debt Holder Profile table required under the Fund's 2020 Debt Limits Policy (DLP).<sup>10</sup> The projection of that

<sup>8</sup> In this Guidance Note, multilateral refers to institutions with two or more sovereign members (and no non-sovereign member).

<sup>9</sup> See a sample country example along with the write up in Annex 1.

<sup>10</sup> The breakdown of multilateral creditors between ADB/AfDB/IADB and other multilaterals in Table 1 follows the presentation in the Debt Holder Profile Table required by the DLP. The breakdown of debt across the different groupings should not be perceived as implying any views on which institution may or may not be a de facto preferred creditor. Collateralized debt may be more difficult to restructure given creditors' security interests in sovereign assets or revenue streams. But any difficulty in restructuring will ultimately depend on the decisions of the borrower and its creditors, the type of security and the specific contractual provisions, and the particular circumstances of each restructuring.

breakdown over time is not required under the DLP but can be easily obtained from the Debt Sustainability Analysis (DSA) files.

<b>Creditor profile</b>	<b>Actual</b>	<b>Projections</b>		
	2021	2022	2023	2024
Total debt <sup>1</sup>				
External debt				
<i>Multilateral creditors</i>				
o/w: IMF and WB				
o/w: IMF				
o/w: ADB/AfDB/IADB				
o/w: Other Multilaterals				
<i>Bilateral creditors</i>				
o/w: Paris Club				
o/w: Non-Paris Club				
<i>Private creditors</i>				
o/w: Bonds				
o/w: Loans				
Domestic debt				
Memorandum items				
Collateralized debt				
o/w: Related				
o/w: Unrelated				
Nominal GDP				
<hr/>				
<b>Multilateral and collateralized debt</b>				
<i>Multilateral debt</i> <sup>2</sup>				
Percent of external debt				
Percent of GDP				
o/w: IMF and WB				
Percent of external debt				
Percent of GDP				
o/w: ADB/AfDB/IADB				
Percent of external debt				
Percent of GDP				
o/w: Other Multilaterals				
Percent of external debt				
Percent of GDP				
Collateralized debt				
Percent of external debt				
Percent of GDP				
<p>1/ Data should be derived from the Debt Holder Profile table as reported by country authorities (see Table 1 in DLP GN), while the projections should be based on the LIC-DSA analyses.</p> <p>2/ Teams may decide to aggregate at the level of multilaterals for the projection period and decide when to stop filling out the projections. When there are concerns with the quality of projections, teams do not need to provide data for the following four lines: ADB/AfDB/IADB, other multilaterals, Paris Club and non-Paris Club; and in cases where the team cannot project WB credit, that may also be left blank.</p>				

## 6. Debt to multilateral creditors may enjoy de facto preferred creditor status (PCS).

- The concept of PCS stems from the recognition by the international creditor community of the special role that the Fund, the World Bank, and certain other multilaterals play in the international financial architecture and the public good nature of such financing. Against that backdrop, official bilateral creditors have been willing to exclude debt to those creditors from the perimeter of the debt restructuring. Private creditors have generally also recognized that exclusion. Multilateral creditor contributions to debt restructurings have been relatively rare and tend to involve new financing. It is very unusual for them to provide debt stock relief (with the

notable exception of the Highly Indebted Poor Country (HIPC) and related Multilateral Debt Relief Initiative (MDRI)).

## 7. Collateralized debt may be more difficult to restructure.

- Collateralization can provide creditors (either commercial or official) with a security interest in assets, revenue streams or other resources from which the creditor can satisfy part or all of its claim in the event of a default, which tends to complicate the restructuring process.<sup>11</sup> Collateral-like features (which are not legally collateral but give the creditor similar protection as collateral such as oil pre-payment agreements) may have similar implications. It is not unusual for project financing to use collateral (e.g., use the revenue stream or assets generated by the project as collateral to finance its investment). But there are also instances where financing involves “unrelated” collateral, e.g., budgetary loans secured by commodity export revenues. Some creditors also require the use of escrow accounts over which security is granted covering upcoming debt service.<sup>12</sup> The difficulty of restructuring a collateralized claim will depend on the nature of the collateral, the jurisdiction where it is located, and the contractual features of the loan agreement, together with the broader sources of bargaining power of the debtor and the other creditors with respect to the creditor with a collateralized claim.
- While collateral can make a debt more difficult to restructure, it does not necessarily mean that it will not be restructured. For example, holders of collateralized commercial claims and non-collateralized official bilateral claims rely on very different approaches. In the event of a restructuring, official creditors may decide not to provide a debt treatment unless the collateralized commercial claim is also treated. In that sense, the collateralization of a claim does not necessarily make it impossible to restructure in practice. But the presence of such debt may still complicate the restructuring process.

**8. The discussion should describe the specific collateralization features that may complicate potential future restructuring.**<sup>13</sup> For example, it may be useful to highlight asset-backed debt obligations where the asset’s revenue-generating stream has been pledged; indirect collateralized debt arrangements operated through Special Purpose Vehicles (SPVs) that extend creditors’ claims to government resources in the event of a default; and commodity-backed debt arrangements, which have implications for the borrower’s ability to service future debt obligations

<sup>11</sup> [The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors - Recent Developments, Challenges, and Reform Options.](#)

<sup>12</sup> Escrow accounts can be useful from a debt management perspective. But if the amount covered under the escrow is significant, it can pose similar challenges as collateralized debt in the event of a restructuring.

<sup>13</sup> It is not straightforward to map from the underlying collateral-like loan arrangements to a hierarchy of difficulty to restructure given that collateralized loan agreements have a wide variety of conditionalities including hybrids with overlapping features. See IMF-World Bank (2020) [Public Sector Debt Definitions and Reporting in Low-Income Developing Countries](#) and [IMF-World Bank \(2020\) Collateralized Transactions: Key Considerations for Public Lenders and Borrowers.](#)

when revenue from future commodity sales are already earmarked and unavailable to service other maturing debt.

**9. Staff should report inadequacies in data on collateralized debt.** Full data on collateralized debt may not be available, including due to non-disclosure agreements. The write-up should briefly note such data gaps. The *2021 Guidance Note on Implementation of the Debt Limits Policy in Fund-Supported Programs* provides guidance on assessing data inadequacies (including on collateralized debt) and remedial measures, and calls for a fuller discussion of data gaps in the DSA. Where appropriate, debt conditionality can help address data gaps, limit new issuances of collateralized debt, and target the reduction of its existing stock.

### Discussion of the Composition and Evolution of Debt Over the Program Horizon

**10. The ES call for an analysis of the composition and projected evolution of debt that may be de facto senior or potentially difficult to restructure.** The analysis should refer both to the current composition of debt and its projected evolution over the program period under the program baseline (which can be derived from the template used in the Low-Income Country (LIC) DSA). The underlying rationale is that protection afforded by the Fund's de facto PCS rests on the presence of a cushion of restructurable junior debt. The analysis should focus on ratios of a) Fund credit outstanding; b) Fund plus World Bank and ADB/AfDB/IADB credit; and c) all IFI credit plus collateralized debt as a share of total external debt. While b) is a good indicator of debt that is de facto senior and normally cannot be restructured, c) is also an important indicator of rigidities in the structure of external debt. The write-up should also discuss the nature of collateralized debt, as noted above.

**11. In discussing the implications of the structure/evolution of debt for CtR, the following considerations may be relevant:**

- A high ratio of debt that is (or may be, in the case of some multilateral creditors) de facto senior or difficult to restructure may be a warning sign of elevated CtR risk. For reference, the average ratio of multilateral debt (including the IMF) to total external Public and Publicly Guaranteed (PPG) debt in LICs is 56 percent and the median is 57 percent, while the 25th and 75th percentiles are 38 and 77 percent, respectively.
- However, a high ratio by itself may not indicate elevated CtR vulnerabilities if debt and debt service ratios are low. The LIC DSA is based on an assessment of vulnerabilities associated with debt and debt service indicators; countries at low or moderate risk of debt distress are likely to have limited vulnerabilities, even if their share of de facto senior/difficult to restructure debt is high.<sup>14</sup>
- A combination of high risk/debt distress and high ratios of debt that may be de facto senior or difficult to restructure debt would be a clear indicator of elevated risk to CtR.

<sup>14</sup> A high ratio of multilateral debt could be associated with lower debt vulnerabilities since multilateral debt typically carries favorable interest rates and maturity structure.

- In cases where a debt restructuring to restore debt sustainability is envisioned under the program, the ES1A discussion (and the associated table) should not include the projected evolution of debt broken down by creditor composition. Such projections could be interpreted as the Fund prejudging or trying to micro-manage the appropriate burden-sharing across creditors (which should be left to the debtor and its creditors). In such cases, a brief discussion of the composition based on latest available data suffices.

## ES1B: ENHANCED SAFEGUARDS ON CAPACITY TO REPAY

**12. ES1B: Program documents must include a discussion of the evolution of projected Fund debt and debt service relative to key economic metrics over the course of the repayment period as compared with other PRGT-supported programs, supported by a set of standardized charts** provided by the Finance Department. Where financing requests would result in comparatively elevated levels of key CtR indicators, the program documents would examine the severity of the implied risks and explain how program design—including access, phasing, and conditionality—seeks to mitigate these risks.<sup>15</sup> Below we provide guidance on how to implement this in practice (also see the sample ES write-up in Annex I).

**13. Existing guidance on CtR requirements in program documents remains in place for program requests not subject to ES.** For requests not falling under the ES, program documents should continue to include a CtR assessment, supported by information from the What-If Projections and the CtR Table. In such cases, information stemming from Finance Department's (FIN's) analytical tool developed for the ES (see below) could inform all program documents involving Fund financing (e.g., requests/reviews of both Upper Credit Tranche (UCT)-quality programs and emergency financing) to further support the CtR assessment.<sup>16</sup> For requests falling under ES, the standard CtR table should continue to be included in program documents at the time of the initial approval of the financing request and in every program review.

### CtR “Dashboard”

**14. ES1B benchmarks a country's Fund credit exposure against a comparator group and presents exposure metrics in a CtR dashboard to be included in program documents.** The dashboard includes relevant economic metrics for the country in question and a comparator group so as to benchmark the Fund's credit exposure to the country in question and signal cases of elevated risk.

<sup>15</sup> See *Fund Concessional Financial Support for Low-Income Countries—Responding to the Pandemic* (Annex VI, p. 62).

<sup>16</sup> This option may help enhance CtR assessments without imposing a significant additional burden on country teams, which need only to provide the needed CtR data for FIN to prepare the CtR charts.

## Economic Metrics

**15. The dashboard should present eight metrics.** These metrics will be illustrated in panel charts showing the evolution of projected Fund credit and debt service to the Fund both for the country in question and the comparator group:<sup>17, 18</sup>

- Six charts focusing on time-series indicators (i.e., projections starting from the year of the program request or augmentation and the following 10 years):
  - Three stock indicators: projected stock of Fund credit outstanding relative to i) GDP, ii) gross international reserves (GIR),<sup>19</sup> and iii) public and publicly-guaranteed (PPG) external debt; and
  - three flow indicators: projected annual debt service to the Fund relative to i) fiscal revenues (excluding grants), ii) exports of goods and services, and iii) PPG external debt service.
- Two cross-section charts highlighting the highest peak credit indicators for the above metrics relative to PRGT countries with top Fund credit exposures,<sup>20</sup> i.e., the two most elevated of the six metrics listed above. The cross-section charts, by comparing exposure metrics to a subset of past programs with top exposures, helps focus the analysis on the most elevated metrics.

## Comparator Groups

**16. The baseline comparator group for the CtR dashboard is based on all UCT-quality programs (including blends) approved for PRGT-eligible countries over the most recent decade.** This sample period includes a sufficiently large number of PRGT arrangements for constructing meaningful benchmarks. It also captures shifts in Fund financing for LICs, including the rising trend in Fund exposure in recent years, and includes enough observations for constructing alternative control groups where merited.<sup>21</sup>

## Elevated Levels of Fund Credit Exposure

**17. The median and interquartile ranges for the control group provide benchmarks for exposure metrics.** In general, CtR risks would be deemed at acceptable levels if projections for all CtR indicators lie below the 75<sup>th</sup> percentile of the respective metric, while levels above the 75<sup>th</sup>

<sup>17</sup> These metrics have been used in practice and suggested in earlier internal CtR guidance to Fund staff.

<sup>18</sup> If teams believe other metrics are more relevant in a particular case, the dashboard can be adjusted, but most of the eight metrics listed below should be retained, and the alternative metrics should draw from the indicators already embedded in FIN's dashboard.

<sup>19</sup> For members of currency unions, GIR could be based on imputed reserves.

<sup>20</sup> The control group of countries with top exposure levels consists of the top quartile of past exposures.

<sup>21</sup> Alternative comparator groups, including *fragile and conflict-affected states* (FCS)—to capture their political and institutional weaknesses; and *presumed blenders*—to reflect their greater access to international capital markets, could be considered but should be used rarely. In such cases, the use of alternative control groups should be communicated to FIN staff by the time country teams share the data for the preparation of the CtR dashboard and should be justified in the ES1B write-up.

percentile would require a deeper analysis (see below). The choice of this benchmark is in line with the July 2021 Board paper on PRGT reforms (Annex VI).<sup>22</sup>

**18. The comparison of the country under assessment against the benchmarks should be combined with staff’s judgment informed by the macroframework, DSA, risk matrix, and other relevant analysis.**<sup>23</sup> Country teams should complement the information provided by the tool with their own country-specific knowledge and judgment to come to an overall assessment of the risks implied by comparatively high exposure metrics. For instance, small and/or temporary deviations above the triggers do not necessarily indicate elevated CtR risks (such as when total debt burden indicators and debt vulnerabilities are modest), or there may be mitigating circumstances. On the other hand, absence of metrics exceeding the 75<sup>th</sup> percentile do not necessarily imply absence of elevated risks and could still require a more careful assessment, including when the outlook is highly uncertain and risks to the program are tilted to the downside, or when small outstanding Fund credit and Fund debt service ratios are a by-product of very high levels of total debt and debt service.

### Deeper CtR Analysis

**19. In cases where elevated metrics of Fund exposure combined with staff judgment indicate high risks to CtR, a deeper analysis of risks and risk-mitigating factors should be included in the ES1B write-up (CtR paragraph).** The write-up should draw from the information conveyed in the CtR dashboard, together with information from the standard CtR Table. Annex I provides a sample CtR write-up for reference. This deeper analysis should particularly focus on the drivers of elevated CtR ratios relative to the control group; the size of elevated ratios; the duration of such levels above the 75<sup>th</sup> percentile; and the economic significance of the identified risks. The analysis could also draw attention to risks associated with the authorities’ willingness and ability to implement reforms needed to strengthen CtR.

<sup>22</sup> This benchmark has also been used to identify heightened risks in somewhat similar situations, including to calculate the thresholds for assessing LICs’ debt carrying capacity (see *Review of the Debt Sustainability Framework in Low-Income Countries: Proposed Reforms*, IMF Policy Paper, September 2017); scrutinize realism of projections (e.g., *Review of the Debt Sustainability Framework for Market Access Countries*, IMF Policy Paper, January 2021); and identify borrowing spaces consistent with LICs’ capacity to repay (see *Macroeconomic Developments and Prospects in Low-Income Countries—2021*, IMF Policy Paper, March 2021). Evidence from the literature (e.g., A. Oeking, and M. Sumlinski, “Arrears to the IMF—A Ghost of the Past?” IMF Working Paper WP/16/225; and C. Oka, “Anticipating Arrears to the IMF: Early Warning Systems,” IMF Working Paper WP/03/18), as well as analysis of past cases of protracted arrears to the Fund, also suggest that arrears are more likely to occur when Fund debt and debt service compared to certain economic metrics reach levels roughly around the upper quartile of the corresponding distribution.

<sup>23</sup> Judgment can be particularly useful when CtR metrics convey mixed signals (e.g., the observations for the same CtR indicator could lie above the 75<sup>th</sup> percentile in some years and below in others); borderline cases (e.g., observations for a CtR indicator could lie above the 75<sup>th</sup> percentile for several years but by a small margin); or in programs requiring debt restructuring, in which case the path of PPG external debt and debt service may be subject to large uncertainty at program inception.

**20. The deeper CtR analysis should also discuss risk-mitigating factors under the program.**

This could include:

- Access. Is proposed access appropriate? Does the proposed access level keep Fund exposure at manageable levels?
- Phasing. Is the phasing and strength of reforms under the program commensurate to the phasing of disbursements, or are disbursements frontloaded while reforms are not?
- Conditionality and program policies. Are there good prospects that program targets and policies will be achieved during the proposed timeframe? Do the proposed policies help reduce elevated CtR ratios over the repayment period?
- Country-specific factors such as magnitude of contingent liabilities, the prospects for growth (or depletion) of natural resource revenues, and burden-sharing with other official creditors. The existence of prior calls on the availability of foreign exchange that could weaken the capacity to repay the Fund (e.g., earmarked revenue or exports proceeds, escrow accounts, collateral) could also be noted (drawing on the discussion in ES1A) and the relevant economic metrics could be adjusted accordingly.<sup>24</sup>

**21. The CtR paragraph in program documents should include a bottom-line assessment of a country's capacity to repay the Fund in the topic sentence.**

This assessment, which should inform a country's program design and the level of access to Fund resources, must also reflect the balance of CtR risks whenever applicable.<sup>25</sup> For a program request to move forward, CtR must be assessed to be at least "*adequate*." In cases of elevated but still acceptable/manageable CtR risks, the bottom-line assessment should be conditional on the balance of risks, e.g., "*CtR is adequate but subject to significant downside risks*." Lastly, in cases where CtR is deemed weak, the request for a Fund-supported program should not move forward unless the program includes clear measures that would restore the member's CtR to at least adequate, even if significant risks remain.<sup>26</sup>

**Downside Scenarios and Realism Checks****22. The CtR dashboard should be based on the baseline macroeconomic scenario but could also include information on downside scenarios where applicable.**

The dashboard should be based on the baseline scenario underpinning the proposed program. However, it could also add information on downside scenarios if these are also included in program documents and a financing arrangement (either drawing or precautionary) is incorporated in that scenario. If no Fund-supported program is assumed under the downside scenario, it would not be included in the CtR

<sup>24</sup> These metrics could be adjusted to reflect their unencumbered values. For instance, if a country has pledged resources under commodity-backed debt arrangements, the pledged flows and stocks could be subtracted from the original amounts of the corresponding metrics. E.g., 2018 EFF request for Angola (Staff Report Table 9).

<sup>25</sup> This applies to all requests, irrespective of whether the ES apply.

<sup>26</sup> Examples of weak capacity to repay include the 2017 RCF request for The Gambia and the 2021 ECF Request for Malawi. In both cases, capacity to repay was assessed to improve contingent on upfront policy actions before the start of the IMF program.

dashboard. Downside scenarios are particularly useful for PRGT-eligible countries that are highly vulnerable to adverse exogenous shocks or requesting precautionary arrangements. Program documents for precautionary SCF or Stand-Credit Facility/Stand-By Arrangement (SCF/SBA) blend arrangements would typically include a downside scenario that would give rise to *potential* balance of payments (BoP) needs, hence justifying drawings. In such cases, the dashboards could be enhanced to also include the downside scenario (see Annex I, Figure 1).

**23. The CtR write-up should also discuss downside scenarios when applicable.** Negative shocks may yield significant deviations from the baseline for the key economic metrics underpinning the CtR indicators. Therefore, in cases where program risks are high and program documents include a downside scenario, a deeper CtR assessment could discuss CtR in the downside scenario, together with policy responses that would mitigate their adverse impact on CtR. The bottom-line assessment should also make a reference to CtR risks under the downside scenario. For instance, “CtR is adequate under the baseline but subject to significant risks, as illustrated by a downside scenario.” See sample write-up in Annex I.

**24. Revisions to the macroeconomic framework during the internal review process would necessitate a revised CtR analysis.** If the macro-framework is revised during the internal review process and/or the access level and phasing are changed, the CtR dashboard and the CtR assessment should also be revised accordingly and reflected in the revised program document.

### Process, Documentation, and Other Issues

**25. Data sharing for preparing the CtR dashboard.** Area departments should share with FIN the underlying data necessary for preparing the CtR dashboard using a standardized Excel file provided to them by FIN. This file should be shared with FIN staff before program documents are posted on eReview so that the CtR dashboard and the CtR analysis can be included in the program document to be sent for departmental review. FIN would require at least one business day to produce the CtR dashboard and send it back to country teams. Revised data should be shared in the Excel file during the internal review process when the baseline and/or downside scenarios or the What-If projections are revised.<sup>27</sup>

**26. Additional reading resources.** The 1990 guidance note on CtR (Assessment of a Member’s Capacity to Service Its Financial Obligations to the Fund) and Annex VI of the July 2021 Board paper (Fund Concessional Financial Support for Low-Income Countries—Responding to the Pandemic) are useful references on CtR issues. Country teams are also encouraged to consult with their FIN reviewers early in the internal review process on any specific issues pertaining to the application of the enhanced safeguard on CtR.

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<sup>27</sup> The data underpinning the samples of control groups will be updated annually by FIN. This update will incorporate all UCT programs approved in the previous calendar year.

## ES2: REDUCING DEBT VULNERABILITIES IN PROGRAMS WITH COUNTRIES AT HIGH RISK OF, OR IN, OVERALL DEBT DISTRESS

**27. ES2 requires that for countries at high risk of, or in, overall debt distress, requests for new PRGT arrangements or augmentations of access include as a core program objective the concrete reduction of debt vulnerabilities over the course of the program and beyond.** This would typically involve reducing breaches of the thresholds for the debt and debt service indicators in the LIC-Debt Sustainability Framework (DSF), but the approach to assessing the projected improvement in debt vulnerabilities should not be purely mechanical: while ES2 requires a discussion of the trajectory over the program of threshold breaches, it does not require a downward trajectory in each one. Rather, the assessment that debt vulnerabilities are being reduced should be holistic, taking account of country-specific factors (discussed below).

**28. ES2 is less stringent than the requirements under the PRGT exceptional access policy.** Both PRGT-EA and PS-HCC require that public debt be assessed to be sustainable in the medium term with high probability, which is generally considered to be met for countries with a low or moderate risk of debt distress: specifically, countries seeking exceptional access to PRGT resources but at high risk of or in debt distress must improve their risk rating to at least moderate within 36 months from Board approval or within the period of the new arrangement (whichever is longer) via a combination of policies and financing from sources other than the Fund (which may include a debt restructuring).<sup>28</sup> By contrast, ES2 does not require an assessment of medium-term debt sustainability *with high probability*; therefore, while the program would be expected to deliver a reduction in debt vulnerabilities under ES2, this would not necessarily entail an improvement in the debt distress rating to moderate within the program period.

**29. If debt is assessed to be unsustainable *ex ante* and the Fund-supported program includes a debt restructuring to restore sustainability, ES2 will be automatically satisfied.** If a country is assessed to have an unsustainable debt position, the Fund would be precluded from providing financial assistance unless the member take steps to restore debt sustainability in the medium term. If donor financing other than from the Fund, together with politically and economically feasible fiscal adjustment is not sufficient to restore sustainability, a debt operation would be needed. It is always for the member to decide whether or not to seek a debt treatment. Approval of Fund financing in such cases would be predicated on the member seeking a debt treatment consistent with restoring debt sustainability, which would also satisfy ES2. Thus, in cases where the program includes debt restructuring to restore sustainability, ES2 is automatically satisfied. Operationally, the ES2 write-up can be very short and refer to the DSA, which would explain how the restructuring would restore sustainability.

<sup>28</sup> For specific requirements under PRGT exceptional access, see Annex II in "Fund Concessional Financial Support for Low-Income Countries – Responding to the Pandemic", IMF Policy Paper No. 2021/053 (July 2021).

## Reduction in Debt Vulnerabilities Under ES2

**30. The ES2 write-up should focus on the evolution of the LIC-DSA debt vulnerability indicators that breach the thresholds under the baseline during the program period and beyond.** The DSA uses four external debt burden indicators: the present value (PV) of PPG external debt relative to GDP and to exports (solvency risks); and the ratio of external PPG debt service relative to exports and to revenues (liquidity risks). There is also an overall public debt burden indicator: the PV of total PPG debt to GDP. The model-based signal for the risk of PPG debt distress is derived by comparing each indicator's projected evolution under the baseline and shock scenarios relative to its statistically determined threshold.<sup>29</sup> The thresholds for each indicator are bounds above which the risk of debt distress is considered to be elevated and vary depending on a country's assessed debt-carrying capacity (low, medium, or high), a determination that is made via a composite indicator using country-specific information.<sup>30</sup> High risk of debt distress is signaled when one or more of the indicators breach the threshold in the baseline; moderate risk occurs when there are no extended breaches in the baseline; and low risk occurs when there are no breaches under the baseline *and* shock scenarios.

**31. Breaches of thresholds under the baseline would typically need to be reduced in order to satisfy the ES2 requirement of reducing debt vulnerabilities.** However, in some circumstances it may not be possible (or appropriate) to reduce all of the breaches continuously over the program period given the nature of the variables in the indicators. Nevertheless, the composite picture of vulnerabilities should show a clear overall improvement, and cases where some indicator breaches widen over part of the program period should be explained and justified.

- There is a strong presumption that debt/GDP and debt/exports would decline over the course of the program, supported by fiscal consolidation and debt limits under the program, as well as by an expectation of growth. However, there could be exceptional cases where the breaches initially widen, e.g., due to front-loaded access or shocks (such as to prices of commodity exports) that reduce exports and/or GDP over the near term.
- The trajectory of debt service is largely fixed in the near term, reflecting past borrowing. In cases where debt service rises over the program period (e.g., due to maturing sovereign external debt in the middle or latter part of the program), it may not be possible to reduce debt service/exports in the near term. The same applies to debt service/revenues: although revenues can be increased under program policies, it may take time to implement such increases, and they may not outweigh a rising trajectory of predetermined debt service. However, where debt service/revenues breaches the threshold, the program would normally be expected to contain policies to mobilize higher revenues.
- The need to rely on judgment to supplement mechanical signals is particularly important where staff have combined the signals from the LIC-DSF model-based rating with judgment based on

<sup>29</sup> Note that for the overall public debt indicators, only the PV of total PPG debt to GDP has a specified threshold.

<sup>30</sup> See "Guidance Note on the Bank–Fund Debt Sustainability Framework for Low Income Countries" (February 2018).

country-specific circumstances to arrive at a final risk rating for external and overall debt distress that differs from the mechanical DSA ratings. Examples of such situations could include cases where a high risk of debt distress rating is based on long-term risks related to climate change, natural disasters, and/or shifts in financing that are projected to cause breaches under the baseline beyond the medium term; situations of unresolved/legacy external arrears; pending debt operations; fragility and/or conflict situations; and limited financing. Indeed, there are some examples where countries have been assessed as having high risk of debt distress despite not breaching any of the LIC-DSF indicators under the baseline in the near to medium term.<sup>31</sup> For such countries, addressing debt vulnerabilities through the reduction in mechanical breaches of the LIC-DSF indicator thresholds during a program may not be applicable.

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<sup>31</sup> Examples include Afghanistan ([IMF Country Report No. 2021/138](#)), Haiti ([IMF Country Report No. 20/123](#)), Micronesia ([IMF Country Report No. 19/288](#)), Samoa ([IMF Country Report No. 2021/056](#)), and Tuvalu ([IMF Country Report No. 2021/176](#)).

## Annex I. Sample Write-up for the Enhanced Safeguards for Country X

### ES1A

1. **The size of Country X's de facto senior debt plus other multilateral and collateralized debt as a share of total external debt is below 50 percent at program initiation and is projected to rise to 50 percent over the medium term under the baseline projection.** These ratios are below the mean and median for PRGT programs and indicate a significant buffer of restructurable debt. At program initiation, debt held by institutions afforded preferred creditor status—the IMF, World Bank, and other major development banks—accounts for 34 percent of external debt; adding debt held by other multilaterals and collateralized debt brings the total to 44 percent. The combined share of such debt is projected to rise to 50 percent of external debt by 2024. Total multilateral plus collateralized debt as a share of GDP is projected to decline significantly under the program, from 32 to 22 percent of GDP.

**Annex I. Table I. Country X: Debt Composition**

Creditor profile	Actual	Projections		
	2021	2022	2023	2024
Total debt <sup>1</sup>	11,477	11,061	10,650	10,022
External debt	10,099	9,678	9,267	8,638
<i>Multilateral creditors</i>	4,010	3,881	3,750	3,615
o/w: IMF and WB	2,168	2,080	1,990	1,896
o/w: IMF	992	952	911	868
o/w: ADB/AfDB/IADB	1,327	1,307	1,288	1,270
o/w: Other Multilaterals	514	494	472	450
<i>Bilateral creditors</i>	3,801	3,518	3,248	2,990
o/w: Paris Club	2,136	2,098	2,065	2,031
o/w: Non-Paris Club	1,666	1,420	1,183	959
<i>Private creditors</i>	2,288	2,279	2,269	2,034
o/w: Bonds	1,373	1,367	1,361	1,220
o/w: Loans	915	912	908	814
Domestic debt	1,378	1,383	1,383	1,383
Memorandum items				
Collateralized debt	547	567	587	609
o/w: Related	438	453	470	487
o/w: Unrelated	113	113	117	122
Nominal GDP	14,129	15,933	16,859	19,456
<b>Multilateral and collateralized debt</b>				
<i>Multilateral debt</i> <sup>2</sup>	4,010	3,881	3,750	3,615
Percent of external debt	40	40	40	42
Percent of GDP	28	24	22	19
o/w: IMF and WB	2,168	2,080	1,990	1,896
Percent of external debt	21	21	21	22
Percent of GDP	15	13	12	10
o/w: ADB/AfDB/IADB	1,327	1,307	1,288	1,270
Percent of external debt	13	14	14	15
Percent of GDP	9	8	8	7
o/w: Other Multilaterals	514	494	472	450
Percent of external debt	5	5	5	5
Percent of GDP	4	3	3	2
Collateralized debt	547	567	587	609
Percent of external debt	5	6	6	7
Percent of GDP	4	4	3	3

1/ Data should be derived from the Debt Holder Profile table as reported by country authorities (see Table 1 in DLP GN), while the projections should be based on the LIC-DSA analyses.

2/ Teams may decide to aggregate at the level of multilaterals for the projection period and decide when to stop filling out the projections. When there are concerns with the quality of projections, teams do not need to provide data for the following four lines: ADB/AfDB/IADB, other multilaterals, Paris Club and non-Paris Club; and in cases where the team cannot project WB credit, that may also be left blank.

**ES1B**

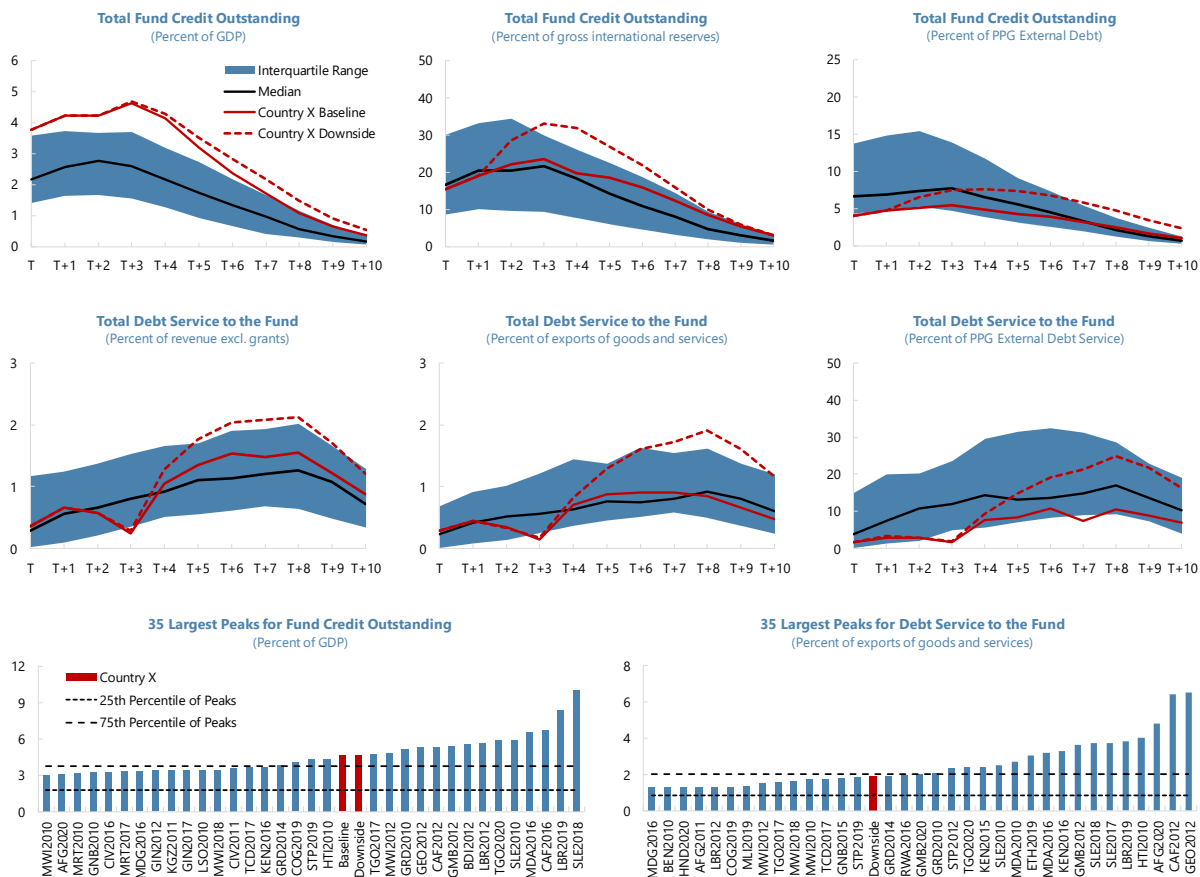
**2. Country X’s capacity to repay the Fund is adequate under the baseline scenario, but subject to significant risks as illustrated by a downside scenario.** Under the baseline, the stock of debt to the Fund as a share of GDP remains at elevated levels based on existing and prospective drawings, peaking in T+3 at almost 5 percent of GDP, well above the 75th percentile of past PRGT arrangements (Figure 1) and among the PRGT’s top exposures in the last decade. However, debt to the Fund as a share of exports and debt service as a share of revenues and exports are not elevated, with indicators of debt service to the Fund close to or below the median for the comparator group. Country X’s capacity to repay the Fund is subject to significant downside risks including from failure of large energy projects, natural disasters, deterioration in the security situation, and materialization of fiscal risks that could reduce the government’s debt service capacity. Risks are mitigated by the authorities’ strong track record of servicing their debt obligations to the Fund, fiscal policy measures envisaged in the program, measures to strengthen governance, and smoothed phasing of Fund disbursements. Risks to capacity to repay are intensified under a downside scenario that assumes significant delays in energy projects, with most Fund credit indicators exceeding the 75th percentile of past PRGT arrangements. However, these risks would remain manageable because Country X is not exposed to large contingent liability risks under the energy contracts and provided the authorities continue to implement structural reforms to support economic diversification.

**ES2**

**3. One of the main objectives of country X’s request for a Fund-supported program is to reduce debt vulnerabilities, including those stemming from the pandemic.** Country X is assessed to be in debt distress, due to pre-HIPC arrears and official arrears to a Paris Club creditor that are being addressed, with the two sides having reached an agreement on the amounts and a repayment plan. Absent these arrears Country X would still be at high risk of debt distress, with all four external debt indicators and the indicator on overall debt above the respective DSA thresholds in the baseline (insert reference to DSA charts showing evolution of the four external debt and the public debt indicators). Debt vulnerabilities will be reduced under the program, as indicated by the downward path of all five debt burden indicators over the course of the program, underpinned by fiscal adjustments (revenue and wage bill measures) and limits on non-concessional debt, along with the prospective economic benefits from the ongoing large investment in liquified natural gas (LNG) projects and a focus on enhanced natural resource revenue management. The baseline external and overall debt-to-GDP indicators remain above the DSA thresholds until the late 2020s, reflecting financing needs arising from the pandemic and the ongoing large LNG investments. The external debt service indicators (relative to exports and revenues) are expected to bottom out temporarily in the medium term at the DSA thresholds but resume their downward trajectory as exports and revenues from the large LNG investments are realized.

### Annex I. Figure I. Country X: Capacity to Repay Indicators Compared to PRGT Countries

(Units as indicated)



**Notes:**

- 1) T = date of arrangement approval. PPG = public and publicly guaranteed.
- 2) Red lines/bars indicate the Ctr indicator for the arrangement of interest.
- 3) The median, interquartile range, and comparator bars reflect all UCT arrangements (including blends) approved for PRGT countries between 2010 and 2020.
- 4) PRGT countries in the control group with multiple arrangements are entered as separate events in the database.

## Annex II. Q&A on the Enhanced Safeguards

1. **What are the three Enhanced Safeguards (ES)?** ES1A requires a granular discussion of the structure and evolution of debt, accompanied by a table. ES1B requires a discussion of CtR risks based on a dashboard showing Fund exposure metrics compared to past PRGT programs. ES2 requires a discussion of how the program seeks to reduce debt vulnerabilities.
2. **When ES are required, should the analysis be included in policy notes and staff reports?** Yes.
3. **When are the ES required?** Program/augmentation requests for countries at high risk of or in debt distress require ES1A, ES1B, and ES2, irrespective of access levels. Requests for access above 100 percent of quota annual or 300 percent cumulative (including total outstanding credit) require ES1A and ES1B; ES2 is not required if the country is at low or moderate risk of debt distress. The ES are not required for RCF/RFI requests or non-financing instruments).
4. **Are the ES required for program reviews?** No, they are required only for requests for new financing arrangements or for augmentation of access.
5. **Are the ES required for requests that entail exceptional PRGT access or high combined access?** ES1A and ES1B are required, but not ES2, since reducing debt to moderate or low is already required under the EA/PS-HCC policies, which will be discussed in the DSA.
6. **Are the ES required for requests in cases where debt is unsustainable and the program includes a debt restructuring to restore sustainability?** ES1A and ES1B are required, but ES1A should present only data on the current composition of debt (not its evolution over the program period). ES2 is not automatically satisfied, since restructuring and adjustment will reduce debt vulnerabilities, which will be discussed in the DSA. Operationally, the ES2 write-up can be very short and refer to the DSA, which would explain how the restructuring would restore sustainability.
7. **If potentially senior or hard to restructure debt (multilateral and collateralized) is comparatively low, e.g., below half of total external debt, is ES1A still required?** Yes, but the discussion can be brief.
8. **If none of the CtR metrics in the dashboard signal elevated risk (e.g., in the top quartile of past programs), is ES1B still required?** Yes, but when the metrics and staff judgment indicate that CtR risks are contained, the CtR discussion can be brief. A deeper discussion is required when the metrics and staff judgment indicate higher risk, in which case the ES1B discussion should examine the severity of the implied risks and discuss how the program would mitigate these risks.
9. **What macroeconomic assumptions should be used for the preparation of the CtR dashboard?** The data and cross-country charts should be based on the baseline scenario underpinning the program request or augmentation. If program documents include downside

scenarios, teams may wish to include such scenarios in the dashboard and analysis. The dashboard charts should then include both the baseline and a second line (or bar) for the downside scenario.

**10. What CtR metrics should be shown in the ES1B dashboard?** The dashboard should include the following eight indicators: Fund credit outstanding as a ratio of GDP, GIR, and PPG external debt; debt service to the Fund as a ratio of fiscal revenue (excl. grants), exports of goods and services, and PPG external debt service; and two charts highlighting the highest peak credit indicators for the above metrics relative to PRGT countries with top Fund credit exposures. If teams believe other metrics are more relevant in a particular case, the dashboard can be adjusted, but most of the eight metrics listed above should be retained and the alternative metrics should draw from the indicators already embedded in FIN's dashboard.

**11. What is the baseline comparator group used in the CtR dashboard?** The dashboard will normally be based on the comparator group of all PRGT financing programs approved in the recent decade. Alternative comparator groups, e.g., FCS or presumed blenders, could be used where appropriate, but this is expected to be rare.

**12. Who will prepare the CtR dashboard?** For the time being, FIN staff will prepare the charts based on data provided by country teams before the PN or SR is finalized.

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