Office Memorandum

To: SEC, Documents Team October 26, 2020

From: Daly, Deirdre /s

Subject: Reform of the Policy on Public Debt Limits in IMF-Supported Programs

The following corrections have been made to SM/20/157, 10/23/2020 scheduled for discussion by the Board on October 28, 2020. They have been approved by SPR(Nolan, Sean).

Corrections appear on the following pages:

Evident Ambiguity

Page: 27 Paragraph: 39 Line: 1-2

Revisions to clarify that the proposals for enhancing debt transparency will apply to all IMF-supported programs.

Page: 34 Paragraph: 55 Line: 1

"Revisions to clarify that the policy would remain unchanged in relation to how debt conditionality is set for the group of countries that do not normally rely on concessional financing, with the exception of the proposals related to enhanced transparency, which also would apply to this group of countries."

Att: (Redlined pages are attached. Corrected data in tables and figures may be colored red in lieu of tracking)

cc: SPR

Box 4. Debt Limits and Commercially Viable Public Sector Entities

Commercially viable SOEs and other such state entities are typically explicitly excluded from debt limits. SOE investment activities and the frequent materialization of contingent liabilities associated with SOEs suggest that they need to be considered for debt limits (unless government debt already includes SOE debt guaranteed by the government). However, when an SOE does not have substantial borrowing activities and/or a reasonably high likelihood of imposing a fiscal burden to the general government, then conditionality would be burdensome, and have little impact on debt vulnerabilities even while potentially restraining development. In such cases exclusion from debt limits would be a better approach.

A case for selective exclusion can be made for commercially viable SOEs that may borrow without a guarantee of the government and whose operations pose limited fiscal risk to the government (similar to the treatment in the LIC DSF).[1] An assessment should cover whether the SOE: (i) carries out uncompensated quasi-fiscal activities, and; (ii) has negative operating balances. Additional relevant indicators to be considered include: SOE's managerial independence; relations with the government (including offering collateral unrelated to the SOE's business when borrowing from the government); the periodicity of audits; publication of comprehensive annual reports and protection of shareholders' rights; financial indices and sustainability; and other risk factors.

[1]See Guidance Note on the Bank-Fund Sustainability Framework for LICs (Appendix III).

A.2. Enhancing Transparency on Debt Holders' Profile

38. **Information on a country's creditor composition can help strengthen program design, including debt conditionality.** The debt holder profile provides information on a country's reliance on international financial markets, domestic and foreign banks, as well as bilateral, plurilateral, and multilateral creditors. Such information is needed to better assess the extent and nature of debt vulnerabilities, such as rollover risks, and therefore would help enhance both the focus and calibration of debt conditionality. For example, debt conditionality could be used to better contain risks posed by the frequent use by some creditors—both official bilateral and private—of non-standard lending instruments (advanced sales of commodities, financing associated with commodity purchase and sale agreements, unrelated collateralized lending, and overcollateralized repurchase agreements). Another example could be debt conditionality designed to encourage diversification of financing sources if is critical for the IMF-supported program to address the risk resulting from a concentrated composition of private sector credit. Such information can also be an important input into understanding the pattern of burden-sharing across additional financing sources within an IMF-supported program.

39. **The revised policy would require that program documents for all IMF supported arrangements include a table providing a profile of the holders of the country's public debt.** Annex I provides an example of the proposed content of the debt holders' table. The table should include the most recent data, to be updated at each program review, provided that confidentiality

features, which can vary substantially across transactions, and recognizing that collateralization of this type can increase the cost of new uncollateralized financing, it is proposed to treat such loans as non-concessional at this juncture.[41] Treating financing involving collateral that is unrelated to the transaction as non-concessional would address potential circumvention problems, which could lead to a build-up of debt vulnerabilities. Note that only the treatment of such transactions as concessional or nonconcessional (and any associated measurement of present value) would be affected; there are no restrictions on the use of such transactions being introduced.[42]

- **The "high concessionality tool" would be eliminated.** Under this proposal, the standard concessionality threshold would apply to all cases (35 percent). Offering a single definition of concessionality would simplify the framework and there would be little loss, if any, in terms of the ability to catalyze concessional financing (since the lending terms of many official creditors are usually pre-determined based on LIC DSF ratings). A higher concessionality threshold would still be allowed in cases, when this is deemed to be an integral part of restoring debt sustainability.

C. Countries that Do Not Normally Rely on Concessional Financing

55. The policy would remain unchanged in relation to how debt conditionality is set for countries that do not normally rely on concessional financing (i.e., countries that use the MAC DSA). In many of these countries, fiscal conditionality would continue to suffice as long as there is comprehensive fiscal coverage and sufficient debt management capacity to handle more sophisticated debt structures. When debt conditionality is critical for the IMF-supported program to address an issue that is not adequately addressed by fiscal conditionality, this debt conditionality would be tailored to this specific debt vulnerability. The reforms to the policy to encourage greater debt disclosure would provide a basis to more rigorously adapt such debt conditionality to country-specific circumstances.

DEBT MANAGEMENT CONSIDERATIONS

56. The proposed reforms to the DLP provide incentives to improve debt management capacity:

- The incentive under the current policy to build and maintain adequate capacity to record and monitor debt would remain: access to flexible PV limits would effectively remain conditioned on

[41] If a standardized form of loans using collateral unrelated to the transaction were to emerge and be widely adopted, it may be possible to develop a methodology for quantifying the non-standard costs of such loans, and hence integrate into concessionality calculations.

[42] Whether collateralized transactions would be subject to specific conditionality—which could proscribe them—would be a case-by-case consideration based on the criticality of the vulnerability potentially created.