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Abstract

State-owned enterprises (SOEs) occupy a structurally ambiguous position between public authority and market discipline, rendering their financial distress uniquely complex. This paper examines the regulatory frameworks governing SOE restructuring at the global and European Union levels and assesses how these models interact with insolvency law and practice, as well as with other public policy objectives. Through comparative case studies from diverse legal and economic contexts, the article examines how SOE distress is managed through a range of restructuring techniques.

By placing EU regulatory approaches alongside non-EU experiences, the article identifies transferable lessons and best practices for balancing creditor protection and the preservation of SOE's essential public functions. The analysis contributes to ongoing debates on the treatment of SOEs in insolvency and restructuring law by proposing a principled framework for managing the "enterprise–state" hybrid during financial crises.

1. Introduction

State-owned enterprises (SOEs) remain central actors in contemporary political economies, not simply as commercial undertakings but as vehicles for delivering public goods, stabilizing strategic markets, and advancing industrial policy.[1] Their hybrid character, operating simultaneously as commercial entities and extensions of the state, makes their financial distress especially challenging to regulate. In neoliberal economies, insolvency law traditionally presumes the neutrality of the state and the primacy of market discipline.[2] SOE restructuring disrupts both assumptions: the state is a dominant stakeholder whose decisions carry fiscal, political, and socio-economic implications; and the enterprise is embedded in public policy commitments that frequently resist the logic of ordinary corporate insolvency.

Although SOEs play a significant role in global production and investment, the legal and institutional mechanisms governing their restructuring remain uneven, fragmented, and often opaque. Some jurisdictions rely on general corporate insolvency regimes,[3] while others create specialized administrative,[4] or quasi-judicial[5] processes. International bodies have not yet developed clear principles for state-related restructuring, and in the European Union, the matter is further complicated by the interaction with state aid rules, fiscal governance, and the Single Market.

This paper analyzes the global and EU regulatory frameworks for SOE restructurings, and the transferable lessons that can be drawn from comparative case studies in Europe and the Americas. By juxtaposing EU approaches with non-EU experiences, the article seeks to draw out cross-jurisdictional lessons to inform a principled framework for managing SOE distress. In doing so, it contributes to current debates in restructuring law, administrative governance, and public finance by reframing the distressed SOE not merely as a struggling enterprise but as a hybrid public asset whose resolution implicates a wide constellation of economic and public interest considerations.

2. Theoretical and Regulatory Framework

2.1. A Global Overview of the State-Owned Enterprise Frameworks for Restructuring Purposes

At the international level, there is no single comprehensive framework that directly regulates or prescribes how state-owned enterprises should be restructured when they fall into financial

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[1] International Monetary Fund, 'State-Owned Enterprises: The Other Government' in Fiscal Monitor: Policies to Support People During the COVID-19 Pandemic (IMF 2020) ch 3.
[2] Emilie Ghio, John M Wood and Jennifer L L Gant, *'Introduction: Insolvency Theory for a New Age'* in Emilie Ghio, John M Wood and Jennifer L L Gant (eds), Research Handbook on Insolvency Law and Theory (Edward Elgar Publishing 2022).
[3] See in Uk, Re Sino-Ocean Group Holding Ltd [2025] EWHC (Ch) (High Court, 3 February 2025).
[4] See in Italy, Legislative Decree No 270, 8 July 1999 (*Nuova disciplina dell'amministrazione straordinaria delle grandi imprese in stato di insolvenza*); Decree-Law No 347, 23 December 2003, converted into Law No 39, 18 February 2004 (*Marzano Law*).
[5] Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), Pub L No 114-187, 130 Stat 549 (2016).

distress. Instead, guidance on SOE's distress is dispersed across several bodies: the International Monetary Fund (IMF), the Organization for Economic Co-operation and Development (OECD), the United Nations Commission on International Trade Law (UNCITRAL), and the World Bank, which offers a Thematic Guidance Note on the topic. Each of these institutions approaches SOEs from a different angle, focusing on governance, fiscal risk, insolvency architecture, or public-sector performance. Together, these instruments form an embryonic soft-law framework for effective SOEs restructuring.

The IMF does not provide SOE-specific restructuring rules. Its involvement arises primarily when the SOE's financial distress creates sovereign fiscal risk or contributes to macroeconomic instability. IMF policies on debt sustainability, financing assurances, and sovereign debt restructuring indirectly shape the treatment of SOEs, especially when governments consider restructuring or guaranteeing SOE debt. The IMF's *Guidance Note on Financing Assurances and Sovereign Arrears Policies* outlines how debt-restructuring decisions must be aligned with efforts to restore medium-term sustainability.[6] Although the guidance specifically excludes SOEs from the category of sovereign entity,[7] these policies influence restructuring options when SOE liabilities are public or publicly guaranteed. The IMF's wider analytical work highlights that many SOEs are systemically non-performing: inefficient, financially risky, and exposed to corruption.[8] For restructuring purposes, it is worth noting that this operational inefficiency may delay the response to financial distress until it reaches a non-viable point.

The OECD Guidelines on Corporate Governance of State-Owned Enterprises (2024) constitute the most authoritative international soft-law instrument governing SOEs' ownership, oversight, and governance.[9] Although the Guidelines do not prescribe specific restructuring procedures, they establish the foundational governance conditions under which SOEs are less likely to deteriorate into financial distress requiring restructuring. The 2024 revision strengthens earlier editions by emphasizing professionalized state ownership, clear rationales for holding enterprises in state hands, and the separation of the state's ownership function from its regulatory and policy-making roles.[10] The Guidelines also reinforce the need for high standards of transparency, disclosure, and accountability, ensuring that SOEs operate under governance practices comparable to those of well-run private firms.[11] They promote competitive neutrality and call for strong, independent, merit-based boards capable of exercising strategic oversight and resisting political interference.[12]

A major innovation in the 2024 update is the integration of sustainability and responsible business conduct into the governance framework. The Guidelines now expect states to set clear sustainability-related expectations for SOEs and for SOE boards to incorporate climate, environmental, social, and long-term value-creation considerations into strategy, risk management,

[6] International Monetary Fund, *'Guidance Note on Financing Assurances and Sovereign Arrears Policies'* (Policy Paper, 2013, updated 2015).
[7] Ibid 17.
[8] IMF, *supra* note 1.
[9] Organisation for Economic Co-operation and Development, *'OECD Guidelines on Corporate Governance of State-Owned Enterprises'* (OECD Publishing 2024).
[10] Ibid 14.
[11] Ibid 19.
[12] Ibid 21.

and reporting. Enhanced sustainability disclosure, aligned with internationally recognized standards, is encouraged to promote consistency and accountability across jurisdictions.[13] Overall, the Guidelines function as a *preventive governance framework*: by improving ownership practices, transparency, and board effectiveness, they help reduce the likelihood of SOE underperformance or financial distress.

Finally, the World Bank's *Integrated State-Owned Enterprise Framework (iSOEF)* guidance note sets out a structured, three-step approach for restructuring SOEs when governments intend to retain them in public ownership.[14]

First, in a rigorous diagnostic phase, the government must assess the SOE's position within its broader economic and institutional context. This diagnosis should encompass an evaluation of the sectoral environment, including applicable government policies, market structure, and competitive dynamics, as well as the legal and institutional framework governing the SOE. It must also critically assess the SOE's mandate and objectives, examining whether they remain appropriate and aligned with current policy priorities and market conditions.

At the firm level, the diagnostic process should incorporate both financial and operational assessments. The financial analysis should consider key indicators such as liquidity, solvency, accumulated arrears, and debt structure to evaluate the enterprise's overall financial sustainability. Simultaneously, an operational assessment should examine efficiency, technological capacity, organisational structure, internal controls, management capability, and relevant sector-specific performance indicators, with a view to identifying structural weaknesses or inefficiencies.

The diagnostic exercise must also extend to the public finance dimension, evaluating the extent of explicit subsidies and implicit state support (including tax arrears or guaranteed liabilities), as well as the scale of contingent liabilities that may crystallise into fiscal obligations. A banking-sector assessment should review the capacity of national banks to absorb loan restructurings or write-offs, the risk of systemic instability, and the extent of cross-exposures between financial institutions and SOEs. [15]

Second, a restructuring plan should be drafted. The guidance note highlights that the success of SOE restructuring is contingent on a careful balance between policy, operational, and financial measures. Financial restructuring without operational reform will not be sustainable, while operational restructuring alone cannot rescue an SOE with an unmanageable debt burden. Measures to restore cost recovery, such as tariff adjustments or the proper budgeting of public service obligations, must balance commercial viability with fiscal responsibility and affordability. Similarly, decisions about debt write-offs or conversions must consider not only the SOE's solvency but also banking sector resilience; aggressive restructuring can jeopardize financial stability if banks are under-provisioned or heavily exposed.[16]

The World Bank's Annex 7 serves as a comprehensive blueprint for governments preparing an SOE restructuring plan. It outlines all components required to understand the SOE's context,

[13] Ibid 23.
[14] World Bank, *'Integrated State-Owned Enterprises Framework (iSOEF)'* (World Bank Group).
[15] Ibid 4.
[16] Ibid 13.

diagnose its problems, identify restructuring options, justify the chosen approach, and articulate the operational and financial roadmap for returning the SOE to long-term viability.[17]

Third, the resulting restructuring plan should be implemented. This should combine financial restructuring with operational and organizational reforms (e.g., changes to business models, strengthening governance, workforce optimization, technology upgrades, and unbundling or corporatization where appropriate). It also should incorporate regulatory and policy reform, especially in public utilities, alongside social mitigation measures for labor transitions.

The World Bank stresses the benefits of centralized ownership entities or dedicated restructuring agencies for coordinating reforms and separating ownership from sectoral policymaking. Yet ontologically and in practice, SOEs operate at the intersection of commercial activity and national policy, and their restructuring often requires political decisions that go beyond purely technical analyses. Whether in tariff reform, workforce downsizing, navigating entrenched interests, or redefining the scope of state ownership, the political salience of SOEs means that governments cannot exclude political judgment from restructuring decisions. The World Bank's aspiration to separate ownership from policymaking provides an important governance benchmark, but the realities of state ownership mean that political considerations inevitably shape restructuring trajectories, sequencing, and feasibility.

Ultimately, SOEs in financial distress face a spectrum of potential interventions, ranging from increased state ownership or full nationalization at one end, to partial or full privatization at the other. Between these poles lies a wide spectrum of restructuring options, reflecting varying degrees of state involvement, market discipline, and institutional capacity. The choice among these pathways is inherently normative, requiring a careful balancing of fiscal sustainability, economic efficiency, and public policy objectives. The absence of a coherent international framework governing State-related restructuring highlights a significant gap in the global financial architecture. Greater attention should therefore be directed towards developing more consistent international principles to guide these processes.

2.2. The European Lens: How EU Law Shapes SOE Restructuring

In line with the global level, the European legal framework does not provide a uniform model either. Nevertheless, there are several fixed reference points useful to address the restructuring of SOEs.

On the one hand, Art. 345 of the Treaty on the Functioning of the European Union provides for the Union's neutrality regarding ownership of public or private enterprises.[18] At the same time, the EU exercises a powerful influence through three regulatory pillars: (i) State aid control, (ii) Competition law, and (iii) Public procurement and transparency rules, especially towards publicly controlled entities.

State aid control is the core of the EU's oversight of SOEs. The European Commission is entrusted with safeguarding the functioning of the internal market and, with regard to SOEs, its

[17] Ibid Annex 7.
[18] Consolidated Version of the Treaty on the Functioning of the European Union [2016] OJ C202/47, art 345.

scrutiny focuses on these entities' competition with private undertakings. Article 107 TFEU prohibits State aid that favors certain undertakings or the production of certain goods, distorts competition, and affects trade between Member States.[19]

The risk of public interference in SOEs is structurally significant; accordingly, the Commission has established a set of control mechanisms. For example, the prior notification of State aid under Article 108 TFEU enables the Commission to assess the selectivity of the measure, the existence of an economic advantage, its imputability to the State, and its compatibility with the internal market. [20] In addition, the Market Economy Investor Principle (MEIP) allows the Commission to verify whether the State's conduct corresponds to that of a private investor operating in a market economy.[21]

The most sensitive and concealed situations concern implicit State guarantees, which may materialize in lower interest rates, facilitated access to credit, or artificially elevated credit ratings; preferential financing granted at below-market rates, on terms more favorable than those available to a comparable private undertaking, or involving a level of risk that a private investor would not accept; and recapitalizations that do not occur under market conditions, namely where no private investor would have participated, where no credible industrial plan exists, or where the expected return is not comparable to market benchmarks.[22]

However, exceptions are provided for economic activities that Member States consider essential to the community but that the market alone would not be able to provide adequately (such as local public transport, universal postal services, energy supply in remote areas, and territorial continuity on certain air or maritime routes). The solution envisaged by the EU legislator is to compensate the undertaking, whether public or private, entrusted with providing these services, for the additional costs arising from public service obligations. To prevent compensation from being granted in situations that fall outside this area of necessity, four cumulative requirements have been identified which, if satisfied, allow the compensation to be excluded from the scope of State aid under Article 107 TFEU.[23]

First, the undertaking must receive a formal mandate to provide a service of general economic interest through a clear act, such as a statute, contract, concession, or administrative decision, thereby excluding all de facto situations. *Second*, the parameters for calculating the compensation must be transparent, objective, and established *ex ante*, so as to avoid discretion or hidden advantages. *Third*, the compensation must be limited to the net costs of the service, including a reasonable profit margin and excluding any form of overcompensation. *Finally*, the undertaking

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[19] Ibid Article 107.
[20] Ibid Article 108.
[21] European Commission, 'Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU' [2016] OJ C262/1, paras 73–77.
[22] Ibid, paras 14–17, 66–77. See, eg, Case C-124/10 P *Commission v EDF* [2012] ECLI:EU:C:2012:318 (implicit State guarantees and the MEIP); Joined Cases C-83/01 P, C-93/01 P and C-94/01 P *Chronopost* [2003] ECLI:EU:C:2003:388 (preferential financing and below-market terms); Case C-482/99 *France v Commission (Stardust Marine)* [2002] ECLI:EU:C:2002:294 (recapitalisations and the private investor test).
[23] European Commission, 'Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU' [2016] OJ C262/1, paras 48–52.

must have been selected through a public procurement procedure, or the compensation must be calculated on the basis of the costs of a typical, well-run, and adequately equipped undertaking.[24]

Once the specific features of State aid control have been identified, attention must turn to the second pillar of the European regulatory framework: the body of antitrust rules applicable to SOEs. In particular, the relevant provisions are Articles 101 and 102 TFEU, on agreements and abuse of dominant position, read in conjunction with Article 106 TFEU, which links those rules to public undertakings and undertakings entrusted with special or exclusive rights. The crucial point is that, save for limited derogations in respect of services of general economic interest, SOEs are fully subject to competition law.

Article 106 TFEU addresses State conduct that creates or protects privileged positions and entrusts the Commission with the task of monitoring their application. Although publicly owned, SOEs are undertakings in every respect and may therefore be parties to restrictive agreements or abuse a dominant position by exploiting exclusive rights, enjoying privileged access to infrastructure, or benefiting from vertical integration facilitated by national legislation. What is at stake is not only the conduct of the undertaking, but also the institutional configuration that the State constructs around the SOE: the exercise of regulatory powers may not be used to create regulatory advantages that render abuse inevitable or structurally embedded.

To render antitrust control over SOEs effective, the European Commission has relied on enhanced transparency of financial relations between the State and public undertakings, most notably through the Transparency Directive,[25] and on accounting separation and structural unbundling between natural-monopoly activities and activities carried out under competitive conditions.

The third pillar of the European regulation of SOEs concerns public procurement, transparency, governance, and accountability, which serve as structural safeguards ensuring that public undertakings operate in line with the principles of the internal market. While State aid control prevents selective advantages and competition law constrains both market conduct and State-created privileges, this pillar focuses on the institutional architecture within which SOEs operate.

Because the State often acts simultaneously as a regulator and a market participant, the EU requires a clear separation of roles and full visibility into financial flows to prevent cross-subsidization, hidden advantages, or distortions of competition. The central instrument is the Transparency Directive, which mandates transparency in financial relations between public authorities and SOEs and requires the accounting separation of monopoly activities from competitive ones.[26]

Beyond financial disclosure, SOEs must adopt governance standards comparable to private undertaking professional independence, managerial autonomy, and clear internal controls—reflecting the influence of the OECD Guidelines on the Corporate Governance of SOEs.

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[24] Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH* [2003] ECLI:EU:C:2003:415, paras 87–95.

[25] Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings and on financial transparency within certain undertakings [2006] OJ L 318/17 (as amended).

[26] Ibid.

Accountability complements transparency by ensuring that decision-making responsibilities are identifiable and that public ownership does not dilute oversight.

Together, these mechanisms ensure that SOEs operate efficiently, competitively and in a manner consistent with competitive neutrality, completing the structural framework established by the first two pillars.

3. Case Studies

In practice, the procedural framework for restructuring a given SOE often depends on which law governs its debt. Where an SOE's debt is governed by local law, then it is typical for the SOE to be restructured under ordinary domestic insolvency laws in a manner not dissimilar to a private enterprise. Where the debt at issue is governed by foreign law, however (as may be the case with, for example, international sovereign bonds), then there is often no formal insolvency regime applicable, and the framework will more closely resemble a sovereign restructuring (which is typically achieved on an *ad hoc*, out-of-court basis).

This section presents four case studies that illustrate the range of frameworks and potential outcomes: (1) the Puerto Rico Electric Power Authority ("PREPA"); (2) the State Agency of Automobile Roads of Ukraine ("Ukravtodor"); (3) Norsk Bibliotektransport ("NBT"); and (4) Alitalia – Società Aerea Italiana S.p.A. ("Alitalia").

3.1 Puerto Rico – PREPA

In 2014, three major rating agencies downgraded debt issued by Puerto Rico (an unincorporated territory of the United States) to "junk" status, triggering a broad debt crisis.[27] In addition to billions of dollars in "general obligation" debt issued by the central government (as well as billions more in off-balance sheet conduit financing), Puerto Rico had numerous SOEs (known as "public corporations"), including the highway authority ("HTA"), building authority ("PBA"), and power authority, with tens of billions of dollars of debt.[28]

The public corporations' debt largely took the form of tax-exempt municipal bonds. Because the debt was governed by U.S. law (generally the law of either New York or Puerto Rico) and dollar-denominated, it could theoretically be restructured under the U.S. Bankruptcy Code. However, due to historical technicalities in the U.S. bankruptcy statute, Puerto Rico, its public corporations, and other political subdivisions were ineligible to seek relief under the Bankruptcy Code.[29] After the U.S. Supreme Court struck down a territorial insolvency law passed by the Puerto Rico legislature as unconstitutional, in 2016, the U.S. Congress passed the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (PROMESA)[30] that closely mirrored Chapter 9 of the U.S. Bankruptcy Code (the section of the Bankruptcy Code governing the restructuring of municipalities and certain SOEs).

[27] Fitch Cuts Puerto Rico's Debt to Junk, N.Y. Times (Feb. 11, 2014), https://archive.nytimes.com/dealbook.nytimes.com/2014/02/11/fitch-cuts-puerto-ricos-debt-to-junk/.
[28] Puerto Rico Oversight, Mgmt. & Econ. Stability Act Oversight Bd., Debt, https://oversightboard.pr.gov/ debt/
[29] Puerto Rico v. Franklin Cal. Tax-Free Tr., 579 U.S. 115 (2016).
[30] Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), Pub. L. No. 114-187, 130 Stat. 549 (2016).

HTA, PBA, and other SOEs were resolved through largely consensual restructuring plans approved between 2018 and 2023. However, Puerto Rico Electric Power Authority (PREPA) has lingered in bankruptcy since 2017, with many observers believing there to be no end in sight.

Steps have been taken by the Puerto Rico government and the Financial Oversight and Management Board (the fiscal control board created under PROMESA to oversee the restructurings) to restructure PREPA's operations over the years, including the privatization of PREPA's generation and transmission operations. The financial restructuring of PREPA's debt, however, has remained stalled because, among other things, the debtor and creditors have long been at an impasse regarding the proper financial and electric consumption projections for PREPA and Puerto Rico, as well as the corresponding amount of debt that PREPA can sustainably service going forward.

Although the reason for PREPA's woes are manifold, two factors unique to SOE restructurings under U.S. law (whether under chapter 9 of the Bankruptcy Code or PROMESA) have contributed to this "gridlock": (1) under PROMESA, the debtor has unlimited exclusivity to propose a plan (*i.e.*, creditors cannot propose their own plan) and (2) there is no "liquidation alternative" (*i.e.*, if the debtor does not propose an acceptable plan of reorganization, creditors cannot force it to liquidate).

So while if PREPA were a privately owned business seeking to restructure under chapter 11 of the Bankruptcy Code, creditors could have long ago sought to propose their own plan of reorganization or forced the debtor into a chapter 7 liquidation, here PREPA's bondholders have no ability to do so for so long as PREPA's case under PROMESA remains pending (and the corresponding automatic stay remains in effect).[31]

3.2 Ukraine – Ukravtodor

Ukravtodor is the state highway authority for Ukraine. In addition to local law, *hryvnia*-denominated debt, Ukravtodor also had $700 million of dollar-denominated bonds issued via international capital markets and governed under English law. These bonds were also guaranteed by the Ukrainian central government, which guarantee ranked *pari passu* with Ukraine's international sovereign bond debt.

Because the bonds were governed by English law, they could not be compromised or otherwise restructured under domestic Ukrainian insolvency law. Accordingly, any restructuring of the bonds issued by Ukravtodor (or other Ukrainian SOEs like the state energy company, Ukrenergo) would more closely resemble an ordinary sovereign bond restructuring than a typical, private sector insolvency proceeding. For example, there would be no centralized court overseeing the proceedings, no generalized moratorium or automatic stay of enforcement actions except as might be imposed by specific legislative act or executive order, and no "cram down" of dissenting creditors or classes except as may be contractually provided under the bond documents (*e.g.*, through collective action causes).

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[31] *Compare* 11 U.S.C. §§ 1112(b)(1) (creditor may seek co nversion of chapter 11 reorganization to chapter 7 liquidation for cause), 1121(d)(2)(A) (chapter 11 debtor's exclusive period to file a plan cannot be extended more than 18 months after bankruptcy petition date) *with* 48 U.S.C. §§ 2161(a) (Bankruptcy Code provisions permitting conversion to liquidation not incorporated into PROMESA), 2172(a) (only the Oversight Board may file a plan under PROMESA).

After the Russian invasion of Ukraine in 2022 left the Ukrainian government with diminished resources to service its international bond debt, Ukraine pursued a restructuring of Ukravtodor's debt in parallel with that of Ukraine's sovereign bonds. In late 2022, Ukraine obtained via consent solicitation a two-year extension of maturities and debt service deferral from its sovereign bondholders, GDP warrant-holders,[32] and certain SOE debtholders, including holders of the Ukravtodor international bonds.

Over the next several years, negotiations on the terms of a more holistic restructuring proceeded. In 2024, Ukraine reached an agreement with its sovereign bondholders and holders of Ukravtodor bonds for a debt restructuring involving a substantial haircut on principle and an exchange into two new debt instruments, which was executed via consensual exchange offer.

3.3 Norway – Norsk Bibliotektransport

Norsk Bibliotektransport (which literally translates to Norwegian Library Transport) began in 2002 as a specialist carrier for books and other library materials within Norway's interlibrary loan system, but over time it developed into a much larger logistics business. It was wholly owned by Biblioteksentralen, a cooperative owned mainly by Norwegian municipalities and county authorities, so the company had an indirect but clear public ownership profile. By the time it failed, NBT was a nationwide operator with around 150 employees, 16 terminals from Kristiansand in the south to Tromsø in the north, automated 3PL warehouses at Kløfta and Larvik, and more than 90 daily routes. NBT also adopted a distinctly green operating model. By autumn 2022, nearly 100 vans had been electrified, and those vehicles were used in a distribution network stretching over 2000 kilometres from south to north. In a country defined by long distances, sparse routes and demanding winter conditions, charging stops could not always be treated as a minor operational detail in the way they might be in short-haul urban transport. At the same time, NBT was no longer limited to moving books for libraries; it had expanded into broader commercial transport, warehousing and third-party logistics.

That combination of public-service origin and commercial expansion is central to the case. NBT's original function was to sustain the practical infrastructure for nationwide access to books, premised on the simple idea that readers should be able to borrow a book regardless of which library in the country held it. That occasionally meant sending a van across the country with only a handful of books on board. Such luxuries could not be afforded when NBT's business expanded, and it had to compete in the ordinary logistics markets. The company invested heavily in terminals, warehouses and sorting technology, adding substantial obligations and commitments to a logistics company with pressed margins and tight liquidity.

The expansion was made possible by the willingness of NBT's immediate parent, Biblioteksentralen, to provide guarantees for NBT's commitments. When NBT's liquidity crisis materialized, the ultimate public owners were not simply deciding whether to inject new money into an already troubled subsidiary. They were also faced with the classic dilemma of whether to continue to fund NBT in the hope that operational performance would improve, rather than seeing

[32] As part of its 2015 sovereign debt restructuring following the Euromaidan, Ukraine issued contingent value instruments colloquially referred to as "GDP warrants" that would pay additional amounts to creditors in the event Ukraine's economy outperformed expectations, measured by comparing GDP growth to a set of pre-determined thresholds.

all guarantee liabilities crystallize in a liquidation proceeding. Choosing the former alternative, NBT sought court-supervised reconstruction in January 2026. As the matter progressed, it became clear that the funding requirement exceeded what the owners were willing to contribute, and NBT filed for bankruptcy (by way of liquidation proceedings in April 2026).

State aid legislation also played a key part in the efforts to restructure NBT. One of NBT's competitors complained to EFTA[33] surveillance authority (ESA), alleging that support from the publicly owned parent, including guarantees, loans and group contributions, or in other reporting interest-free loans, could have conferred an advantage in competition with private logistics firms. As NBT went into bankruptcy, this is now a question mainly of theoretical interest. However, had ESA decided that Biblioteksentralen's financial assistance to NBT constituted state aid, the resulting restitution claims would further have added to NBT's challenges, as such restitution claims could not necessarily be compromised in the reconstruction proceedings.

3.4 Italy – Alitalia

Alitalia, Italy's former flag carrier, experienced a prolonged period of financial distress spanning more than two decades. Although privatized in 2009, the airline remained closely tied to the Italian state through repeated public interventions aimed at preserving essential air transport services, employment, and national connectivity. Throughout this period, Alitalia accumulated persistent operating losses, structural inefficiencies, and growing indebtedness, which ultimately led to its placement into Italy's Extraordinary Administration (EA) procedure in 2017.

Unlike an ordinary corporate insolvency process, EA is designed specifically for large enterprises of strategic importance. It allows operations to continue under government-appointed commissioners while efforts are made to restructure or sell the business. In Alitalia's case, EA enabled the airline to continue operating for several years despite its insolvency, with the objective of maintaining uninterrupted air services while identifying a viable long-term solution. During this period, the Italian government provided various forms of financial support, including bridge loans and liquidity measures, to sustain operations.

These interventions, however, were subject to strict scrutiny under EU State aid rules. Successive measures adopted by the Italian authorities triggered a review under Articles 107 and 108 TFEU,[34] reflecting the tension between the public interest in maintaining essential services and the need to preserve competition within the internal market. As in other SOE contexts, the availability of public support extended Alitalia's operational life but also delayed a definitive restructuring outcome, contributing to a cycle of repeated interim solutions rather than a comprehensive resolution.

Over time, it became clear that Alitalia's financial and operational difficulties could not be resolved within the existing corporate structure. After several unsuccessful attempts to restructure or sell the business during the EA proceedings, Italy ultimately pursued a more structural solution. In 2021, a new airline, ITA Airways, was established as a legally and economically distinct entity. The

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[33] European Free Trade Association.

[34] E.g. Commission Decision (EU) 2022/795 of Sept. 10, 2021 on State Aid SA.48171 (2018/C) (ex 2018/NN, ex 2017/FC) Implemented by Italy, 2022 O.J. (L 141), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022D0795.

transfer of selected assets and operations from Alitalia to ITA was carefully structured to comply with EU State aid rules, in particular the requirement that there be no "economic continuity" between the two entities.

Following this separation, ITA commenced operations as a new carrier without assuming Alitalia's historical liabilities, effectively bringing the long-running restructuring process to a close. This outcome illustrates a distinct pathway for resolving SOE distress in the European context, where regulatory constraints may necessitate not the reorganization of the existing entity but the creation of a successor free from legacy obligations.

Alitalia thus provides a clear example of how the interaction between public ownership, State aid law, and insolvency frameworks can shape the restructuring options available to distressed SOEs. While EA ensured continuity of essential services, it also demonstrated the limits of insolvency tools where political considerations and regulatory constraints prevent a timely and comprehensive restructuring, ultimately requiring a more radical structural break.

4. Lessons learned: Transferable best practices from the above analysis

The comparative assessment of international guidance, the EU regulatory framework, and jurisdiction-specific case studies indicates that effective SOE restructuring depends on a careful balance among institutional discipline, market-oriented tools, and politically workable governance arrangements. Despite the diversity of legal and economic contexts in which SOEs operate, several broadly applicable lessons can be identified.

Successful restructuring consistently begins with a thorough and multidimensional diagnostic phase that examines financial conditions alongside operational performance, governance structures, and public policy objectives. Evidence from multiple jurisdictions shows that restructuring efforts are likely to fail when financial interventions are pursued in isolation, without addressing underlying inefficiencies, outdated mandates, or governance weaknesses. Delays in conducting such diagnostics, often driven by political hesitation, tend to exacerbate financial distress and limit the viability of market-based solutions. By contrast, rapid and coordinated assessments, particularly in crisis contexts, can support timely and credible interventions. Accordingly, restructuring strategies should be grounded in a comprehensive evaluation of mandate relevance, financial sustainability, contingent liabilities, and sector dynamics, with findings presented transparently to build trust among stakeholders.

Another key lesson is the importance of aligning restructuring tools with market discipline and the principle of competitive neutrality. The EU experience demonstrates that public intervention in SOE restructuring must remain consistent with market logic, ensuring that state support does not distort competition. Mechanisms such as state aid control and investor-based benchmarks illustrate how public authorities can emulate private sector behaviour when allocating resources. Comparable dynamics are observable outside the EU, where structured frameworks that protect creditors and constrain discretionary intervention tend to produce more disciplined outcomes. As a result, best practice requires that public support be transparent, proportionate, and structured in ways that minimise competitive distortions while preserving incentives for efficiency.

A further recurring insight concerns the need to clearly separate the State's roles as owner, regulator, and policymaker. Where these functions overlap, restructuring processes are often undermined by conflicts of interest, weakened accountability, and susceptibility to political interference. International and EU frameworks consistently emphasise the benefits of professionalised ownership arrangements and institutional separation, which enhance transparency and reduce the risk of cross-subsidisation. Experience shows that blurred boundaries between industrial policy objectives and ownership decisions can prolong crises and erode credibility. Effective restructuring therefore depends on the establishment of independent and professionally staffed entities with clearly defined mandates and accountability structures.

The evidence also makes clear that financial restructuring alone is insufficient to ensure long-term viability. Sustainable outcomes require a parallel focus on operational improvements and governance reform. Debt restructuring, recapitalisation, or asset disposals can provide immediate relief, but without accompanying changes to business models, efficiency levels, and oversight mechanisms, such measures merely defer underlying problems. Case studies suggest that successful restructurings combine financial measures with operational adjustments, such as workforce optimisation and technological modernisation, and governance reforms, including stronger boards, enhanced controls, and greater transparency. In some instances, creating a new operating entity has been effective, provided it is accompanied by a fundamental redesign of governance and strategy.

Procedural predictability and meaningful creditor engagement are equally critical to effective restructuring. Processes that lack clear rules, defined timelines, or balanced negotiation dynamics often become protracted and produce suboptimal outcomes. Experience demonstrates that when either the State or creditors can unilaterally dominate proceedings, incentives for compromise diminish. Conversely, structured engagement mechanisms, such as formal negotiation frameworks or clearly defined creditor rights, help facilitate cooperative and timely resolutions. Predictable procedures not only improve efficiency but also enhance credibility, encouraging participation and reducing litigation risks.

Finally, SOE restructuring must carefully balance the preservation of essential public services with the need to maintain fiscal sustainability. Many SOEs are responsible for delivering critical infrastructure and services, making their restructuring both economically and politically sensitive. Frameworks that clearly define and cost public service obligations provide a useful model for reconciling these competing objectives. However, experience shows that poorly defined or open-ended commitments can undermine fiscal discipline and prolong inefficiencies. Best practice, therefore, requires that public interest considerations be explicitly articulated, transparently funded, and subject to periodic review, ensuring that service continuity does not come at the expense of long-term sustainability

5. Conclusion

The case studies illustrate how restructuring State-Owned Enterprises requires navigating the space between Leviathan and the market, where public mandates and market discipline intersect.

Taken together, the foregoing case studies underscore that effective restructuring of state-owned enterprises (SOEs) cannot be achieved through isolated legal or financial tools. Rather, it requires a principled and multi-layered framework that combines diagnostic clarity with carefully calibrated, market-compatible interventions. Central to this approach is the institutional separation between the State's roles as owner, regulator, and creditor, supported by meaningful governance and operational reforms that address the underlying causes of distress.

At the same time, restructuring frameworks must provide predictable procedures capable of balancing creditor rights with the continuity of essential services. This includes embedding appropriate safeguards for the public interest without distorting competitive conditions or entrenching inefficient market structures. Equally important is an awareness of the political economy surrounding SOEs, where strategic, social, and symbolic considerations often shape outcomes as much as legal and financial constraints.

CHAPTER 3

STATE-OWNED ENTERPRISES: THE OTHER GOVERNMENT

Introduction

State-owned enterprises (SOEs) influence the economy and people's lives through the provision of goods and services in ways that are distinct from, and more varied than, the direct action of governments.[1] In many countries, SOEs provide basic services such as water, electricity, and transportation to people and firms, as well as loans to businesses. SOEs are diverse, varying in size, sector of operation, complexity, sophistication, and extent of government ownership and control. Some are essentially an arm of the government, whereas others have a mix of public and private owners (mixed ownership) and a greater commercial focus. Many SOEs are among the largest companies in low-income developing countries, emerging markets, and advanced economies.

SOEs have become more prominent in global markets, stimulating renewed interest and debate about their international impacts. Although a few SOEs have had operations abroad for decades, especially in the natural resources sector, SOE cross-border activity has diversified and increased in this century (Cuervo-Cazurra and others 2014). The growing internationalization of SOEs has fueled apprehension about their potential pursuit of noncommercial objectives or unfair competition given that they often benefit from government support, including subsidies or cheaper finance.

At the same time, many governments struggle to manage SOEs effectively. Widespread concerns exist that many SOEs are inefficient, involve significant risks to government budgets, and are a conduit for corruption (April 2019 *Fiscal Monitor*; Musacchio and Pineda Ayerbe 2019; OECD 2018b; Richmond and others 2019; Wilkinson 2018). Getting the most out of SOEs is critical because many governments rely on them to serve their citizens and to foster economic and social development. Drawing from countries' experiences with SOEs, this chapter focuses on how to use them wisely and improve their performance and addresses the following questions to guide the discussion, analysis, and recommendations:

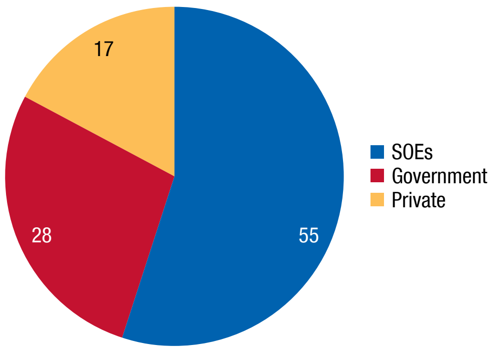
- Do SOEs deliver value for taxpayers' money? Specifically, are they fulfilling their economic and social policy mandates, while operating efficiently and not burdening the budget? Are policy mandates well defined, adequately funded, and contributing to economic and social goals?
- How can governments manage the challenges and risks associated with SOEs? Do governments have clear strategies and institutions with which to regularly evaluate SOE performance and assess whether each SOE is the best tool to achieve a policy goal?
- Does the internationalization of SOEs bring new challenges? SOEs frequently benefit from explicit or implicit government support. Does this support compensate only for the cost of pursuing policy mandates, or does it give SOEs competitive advantages over private firms? Can SOEs contribute to other global goals (for example, curbing domestic pollution and mitigating climate change)?

SOEs' Evolving Landscape

SOEs grew in size and importance throughout most of the twentieth century. European governments began nationalizing key industries in the early 1900s (France, Germany, Italy, Spain, United Kingdom). The trend continued in Central and Eastern Europe in the aftermath of World War II (Allen and Vani 2013; Musacchio and Lazzarini 2014) and in Africa and Asia with the end of colonialism in the 1950s and 1960s. By the early 1980s, SOEs accounted for 8 percent of output, on average, in advanced economies and 15 percent in developing countries (Sheshinski and Lopez-Calva 2003).

[1]Although no commonly accepted definition of an SOE (European Commission 2013; IMF 2014; OECD 2015) exists, there are some shared elements: (1) the entity has its own, separate legal personality; (2) the entity is at least partially controlled by a government unit; and (3) the entity engages predominantly in commercial or economic activities. As noted in the *Government Financial Statistics Manual 2014* (IMF 2014), assessing government control of an entity involves judgment. A government may exercise significant influence over corporate decisions even when it owns a small number of shares. For the quantitative empirical analyses in this chapter, a firm is considered state owned if the government owns at least 50 percent of its equity; in some exercises, the analysis focuses on cases where the governments owns at least 20 percent.

Figure 3.1. SOEs' Share of Infrastructure Investments in Emerging Markets and Low-Income Developing Countries
(Percent of total investment value, 2017)



Source: World Bank 2017.
Note: SOEs = state-owned enterprises.

Beginning in the 1980s, disappointment led to efforts to introduce a profit motive in SOEs through corporatization (that is, incorporating SOEs under the same commercial laws as private firms) and partial or full privatization in many countries. The transition to market economies that followed the dissolution of the Soviet Union in 1991 reinforced these trends. More recently, China's rapid growth combined with the large presence of SOEs in its domestic economy has generated renewed interest in whether SOEs can be used as vehicles for development. In contrast, other countries have recently announced new privatization plans (Brazil, Egypt, India, Morocco).

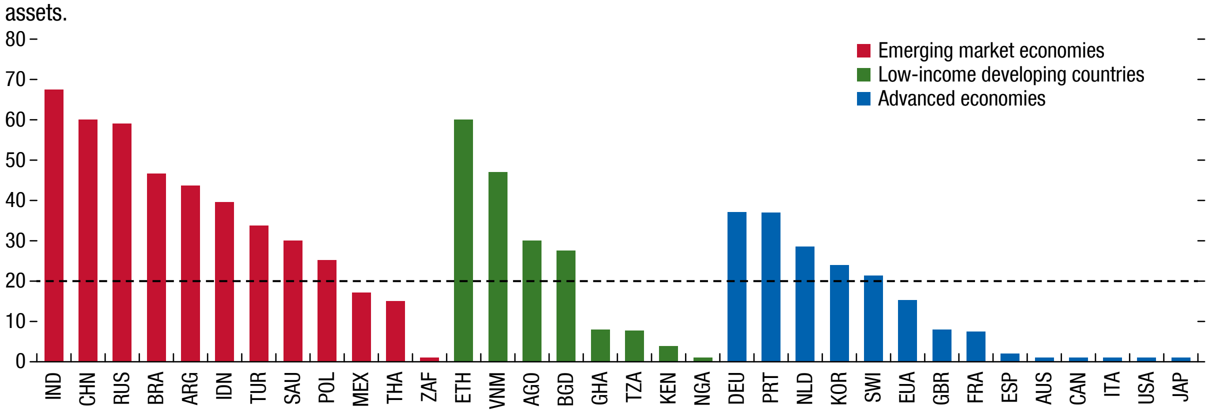
SOEs Are Diverse and Dominant in Core Sectors of Modern Economies

SOEs operate in virtually every country in the world. In some, they number in the thousands (China, Germany, Italy, Russia, Sweden, Ukraine) and are owned by national or subnational governments. SOEs owned by subnational governments, such as local bus, sewer, and water services, often outnumber SOEs owned by the central government. SOEs are among the largest corporations in some advanced economies (France, Italy, Norway) and comprise one-third or more of the largest firms in several emerging markets (China, India, Indonesia, Malaysia, Russia, Saudi Arabia, United Arab Emirates) (Kowalski and others 2013).

SOEs provide goods and services in almost all sectors of the economy but are especially prevalent in the key network sectors—banking, utilities, and transportation. They also manufacture everything from shoes to locomotive engines, manage real estate, and provide phone services. In Africa and Asia, SOEs dominate power generation. SOEs accounted for more than half of all infrastructure project commitments in emerging market economies and low-income developing countries in 2017 (Figure 3.1). Moreover, banking sector SOEs account for 40 percent or more of banking system assets in the BRIC economies (Brazil, Russia, India, China) and some low-income developing countries, and one-third or more in Germany and Portugal among advanced economies (Figure 3.2).

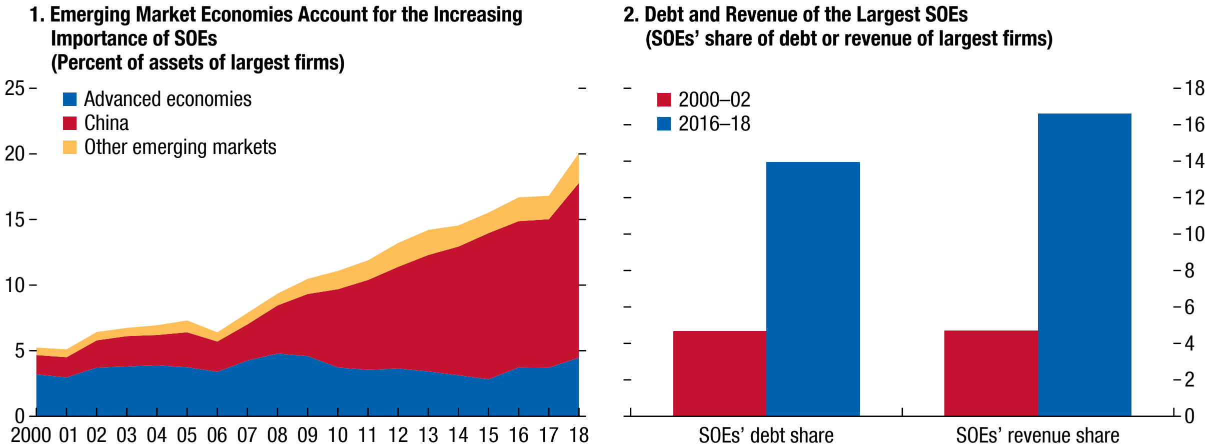
Figure 3.2. Public Banks' Share of Banking System Assets, 2016
(Percent)

In half of the G20 countries and several large developing economies, public banks hold around 20 to 60 percent of the banking system assets.



Sources: CEIC (China); central banks (Ethiopia, Italy, Japan); World Bank, Bank Regulation and Supervision Survey 2019.
Note: State-owned banks are those with at least 50 percent of equity owned by national or subnational governments. Data labels use International Organization for Standardization (ISO) country codes.

Figure 3.3. Share of Nonfinancial SOEs among the Largest Firms



Sources: S&P Capital IQ; UNCTAD; S&P Global UDI World Electric Power Plant database; and IMF staff estimates.
Note: Panel 1 shows the share of SOE assets among the world's 2,000 largest firms. Panel 2 shows aggregate average values of SOE debt and revenue among the world's 2,000 largest firms. The latter is a composite ranking of separate rankings of 2018 revenue and assets obtained from Capital IQ. SOE = state-owned enterprise.

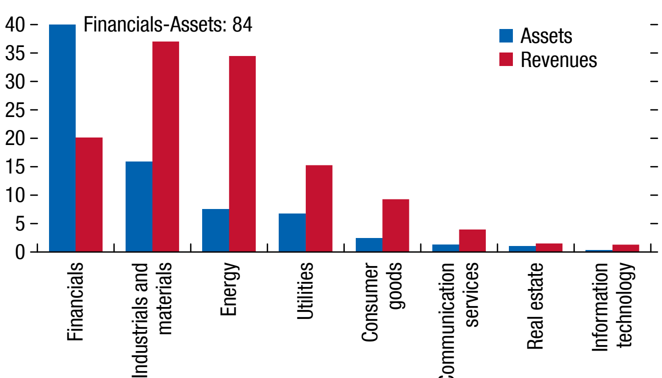
The Largest SOEs Have Become Global Players

Over the past decade, the share of SOE assets among the world's 2,000 largest firms has doubled to 20 percent (Figure 3.3, panel 1). At $45 trillion in 2018, these assets are equivalent to 50 percent of global GDP. An important factor has been the relatively high economic growth rate of emerging market economies and especially of China, where SOEs still play a large role in the domestic economy (see the country case study in Online Annex 3.1). However, the balance sheet expansion also reflects international activities, for example SOEs have accounted for 5–15 percent of annual cross-border acquisitions since 2008 (UNCTAD 2019). The same dynamics are behind the doubling of SOEs' share of debt and revenue of the world's largest firms since early 2000 (Figure 3.3, panel 2). The debt of the largest SOEs is $7.4 trillion, compared with $1.4 trillion in 2000. SOEs have become big players in global corporate debt markets. They now comprise one-third of the entire emerging market sovereign hard currency debt tracked in the most widely followed emerging market sovereign bond index (October 2019 *Global Financial Stability Report*). In terms of sectors, large SOEs are especially active in banking, energy, industrials, and utilities (Figure 3.4). For example, national oil companies are among the biggest oil companies in the world and control more than half of the global oil and gas production.

Many SOEs are no longer wholly owned by the government. Among the largest SOEs in the world, almost 60 percent have a mix of public and private sector owners. Greater prominence of mixed ownership originates in the European privatization strategies that began in the 1980s, in which governments chose to preserve a majority, or in some cases minority, position in the firms (OECD 2016a).[2,3] This approach

Figure 3.4. SOEs' Share of Assets, by Sector

(Percent of assets or revenues of largest firms, by sector)

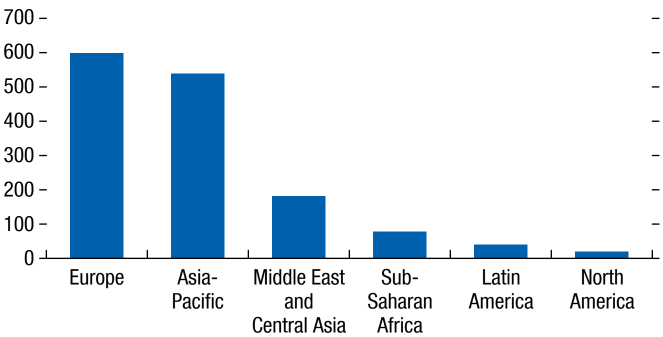


Sources: S&P Capital IQ; UNCTAD; S&P Global UDI World Electric Power Plant database; and IMF staff calculations.
Note: The figure shows the share of SOE assets and revenues by sector among the world's 2,000 largest firms. The latter is a composite ranking of separate rankings of 2018 revenue and assets obtained from Capital IQ. SOE = state-owned enterprise.

[2]The motivations for these approaches varied but included the intention to privatize gradually and to keep a presence in sectors viewed as strategic.

[3]At the end of 2000, governments retained control of more than 60 percent of the 141 privatized firms from developed economies that Bortolotti and Faccio (2009) analyzed.

Figure 3.5. Multinational SOEs around the World
(Number of firms per region)



Sources: UNCTAD; and IMF staff calculations.
Note: SOEs = state-owned enterprises.

to privatization subsequently gained traction with emerging markets (for example, Brazil and China) and emerging market and developing economies.

Today, many of the largest SOEs are also multinationals (state-owned multinational enterprises, or SOMNEs), several with mixed ownership. A SOMNE is an SOE that controls assets of other entities in countries other than its home country. SOMNEs are spread around the world (Figure 3.5), but most originate in China, members of the European Union, India, Malaysia, Russia, South Africa, and the United Arab Emirates (UNCTAD 2019).[4] Some are regional, whereas others are global players. In 2018, half of the top 10 (as measured by revenue) nonfinancial firms globally were SOMNEs. The list of the largest nonfinancial SOEs includes China National Petroleum, Volkswagen AG, Saudi Arabian Oil Company, and Russian firms Gazprom and Rosneft (Figure 3.6). SOEs evolve into SOMNEs for various reasons. Some desire to raise profitability, secure access to natural resources, or obtain technological knowledge. In other cases, some authors (for example, Cuervo-Cazurra and others 2014) have suggested that the objectives may have been partly political, as the business case seemed to be limited.

The Evolving Nature of SOEs Exacerbates Policy Challenges

The evolution of SOEs accentuates existing challenges. Mixed ownership blurs the distinction between *state owned* and *privately owned*—making it more difficult to ascertain when governments are influencing a firm's business decisions. For example, the state may have only a direct minority shareholding in a company but exercise significant control over strategic decisions through a golden share, which can give it special voting privileges, or through other mechanisms (such as indirect ownership whereby the government owns stakes in public banks, public pensions funds, or sovereign wealth funds, that in turn own shares in a company).[5]

The growing global reach of SOEs means SOE-induced competitive distortions in the home market may be spilling over to the global market. Governments often provide support to SOEs to compensate them for pursuing policy goals. This support can be in the form of budget compensation (such as subsidies or capital transfers) but can also include cheap debt and equity financing, special tax and regulatory provisions, a privileged market position, superior access to information, and rescues from bankruptcy. However, government support may not be linked to a specific public mandate or may exceed the net cost of the mandate. In this case, government support can give the SOE a competitive advantage over private firms. For example, Deutsche Post (and its predecessors) over a period of 25 years until 2000 used profits from its letter delivery monopoly to cross-subsidize below-cost selling in the market for business parcel delivery (Capobianco and Christiansen 2011). More fundamentally, public ownership itself can be a source of implicit government support. Private creditors may offer more favorable terms to an SOE than they would to similar private firms and expect that the government would bail out the SOE if needed. IMF staff estimates based on a sample of SOEs in 65 countries suggest that SOEs benefit from lower debt-financing costs, on average, relative to private firms (Figure 3.7).[6]

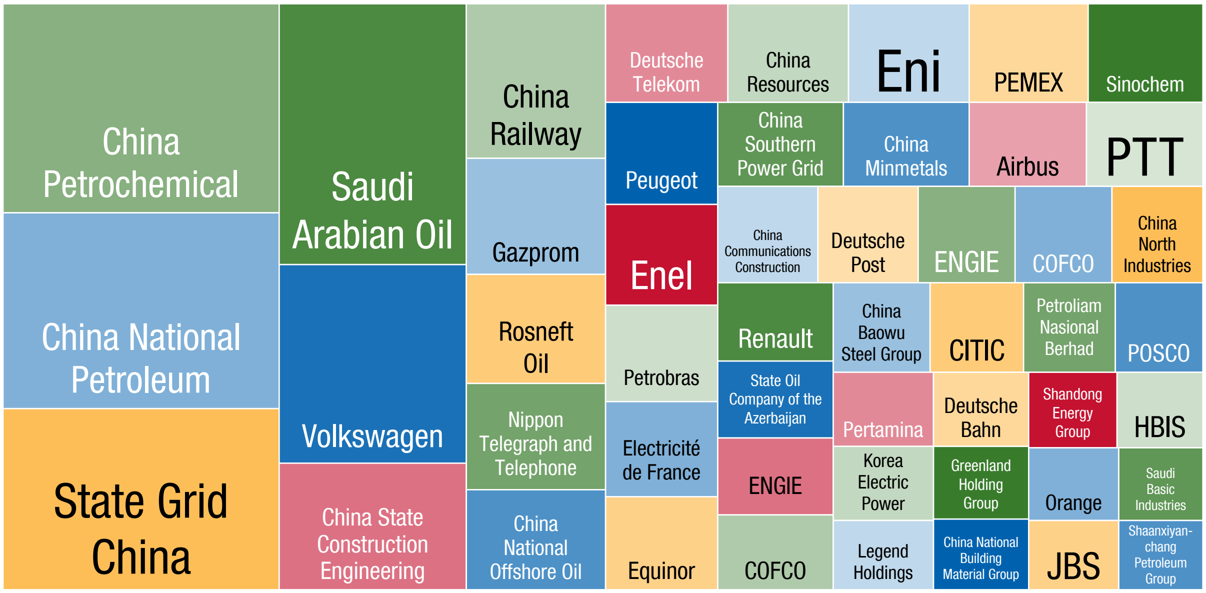
SOEs' government-bestowed competitive advantages can have economic and fiscal implications domestically and internationally. For example, the advantages may distort competition (that is, tilt the playing field in favor of SOEs) or sustain inefficient SOEs, possibly lowering growth and tax revenues. The concerns with

[4]The UNCTAD data set contains 1,500 SOMNEs identified by the United Nations as of 2018 and includes both publicly traded and non–publicly traded state-owned firms in 109 countries.

[5]For example, the German state of Lower Saxony has only 20 percent of the voting rights in Volkswagen but, legally, also has a veto right over key decisions such as factory closures, mergers, and acquisitions (Cremer 2017).

[6]For example, in Vietnam, the state-owned bus company has higher operational costs than its private competitors but benefits from lower borrowing costs resulting from government guarantees (PPIAF 2016).

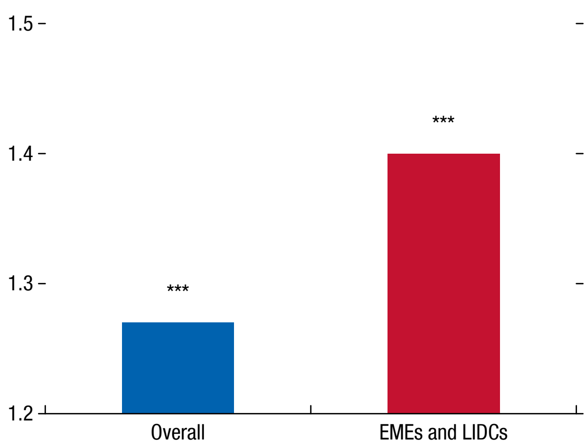
Figure 3.6. Top 50 Nonfinancial SOEs
(Percent of revenues relative to total revenues in largest 2,000 firms)



Sources: S&P Capital IQ; S&P Global UDI World Electric Power Plant database; UNCTAD; and IMF staff calculations.
Note: The largest 2,000 firms is a composite ranking of separate rankings of 2018 revenue and assets obtained from Capital IQ.

government support, for example, are present in the aluminum, semiconductor, and steel sectors. Recent studies of the aluminum and semiconductor sectors estimated that firms, including SOEs, in these industries received sizable government support through budget support, subsidized inputs, below-market loans, and equity financing (OECD 2019a, 2019b). Another study estimated that SOEs produced one-third of global steel output in 2016 amid private sector complaints that SOE peers received unfair government support (Mattera and Silva 2018). In all three sectors, overcapacity is a concern. Moreover, if foreign governments view SOEs' expansion abroad, either directly or indirectly supported by the home government, as a means to achieve foreign policy or national security goals, they may unilaterally take measures to counteract that expansion.

Figure 3.7. Private Firms' Interest Premium, 2000–17
(Percentage point difference to SOEs' interest rate)



Sources: Orbis; and IMF staff estimates.
Note: The sample includes 65 countries, of which 37 are emerging market and developing economies. Interest was calculated as firm interest paid in (t) divided by the stock of debt in (t–1). The analysis controls for firms' size and economic sector. EMEs = emerging market economies; LIDCs = low-income developing countries; SOEs = state-owned enterprises.
*** indicates statistical difference from zero at 1 percent significance level.

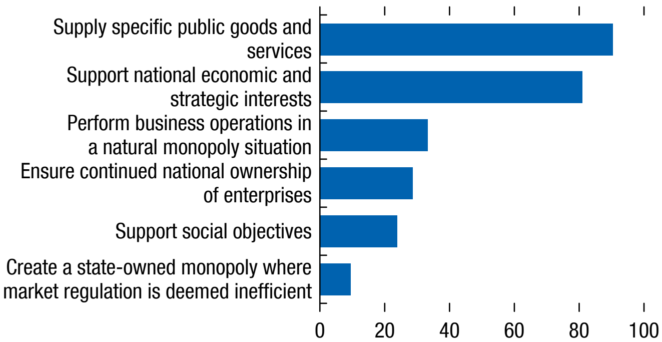
In the next sections, the chapter reviews international experiences on the old and new challenges that governments face in managing SOEs. The chapter also discusses how countries can boost SOEs ability to meet their public mandates in an efficient manner, while promoting fair competition.

Achieving Policy Objectives

Struggling to Meet Policy Mandates

Governments mandate SOEs to pursue a diverse set of policy goals (Figure 3.8). In general, government intervention through SOEs is often justified to correct market failures. One example of market failure is a natural monopoly, wherein the initial cost of building the

Figure 3.8. Objectives of SOEs in CESEE Countries
(Percent of respondents)



Source: Richmond and others 2019.
Note: Responses from governments of CESEE countries to a survey about the nonfinancial objectives of SOE ownership. CESEE = Central, Eastern and Southeastern European; SOE = state-owned enterprise.

infrastructure to provide the good or service, such as water and sewer systems, is so large that private firms may be reluctant to enter the market. Another example is when it is not possible to charge individuals for use of the good (for example, street lighting), which means that private firms may not provide enough of it. In other instances, SOEs are established to develop new sectors, especially in developing countries, such as the copper-mining sector in Chile in 1976 or the oil and gas sector in Ghana in 1983. However, SOEs can also be found producing goods and services in a competitive environment (for example, soft drinks, cars, or cleaning services) without a clear, specific policy mandate. SOEs are sometimes used to pursue broad macroeconomic goals, such as promoting credit growth.

SOEs, especially in emerging market economies and low-income developing countries, have faced challenges in trying to achieve policy mandates, often multiple ones, within a sustainable business model. A core problem has been that these mandates are not clearly specified or adequately costed. Another common weakness is limited transparency of SOE operations and their financial relations with government. These challenges lead to the following problems:

- *Unfunded mandates*: The lack of clear and funded mandates can weaken the financial health of SOEs.[7] For example, firms' lack of freedom to set prices or tariffs to cost-recovery levels—in an attempt to ensure the affordability of goods or services—could lead to systematic losses. This can result in a buildup of SOE debt, including arrears, and inefficient provision of the good or service (such as deterioration of the railway network from lack of maintenance) or limited accessibility (for example, the electricity grid not reaching rural areas) (Ter-Minassian 2017). Similarly, if an SOE is asked to promote employment, higher labor costs may weaken the firm's efficiency and financial viability.
- *Government bailouts:* The expectation that governments will eventually compensate, or bail out, the SOE for losses may provide managers with incentives to not pursue efficiency, to take larger risks, or to borrow excessively.
- *Weak governance and oversight:* In many countries, government agencies do not have sufficient information or capacity to properly monitor SOEs, and others lack guidelines for financial reporting by SOEs (Allen and Vani 2013). More generally, weak governance and corruption are among the main sources of the difficulties that SOEs face (April 2019 *Fiscal Monitor*; Wilkinson 2018).
- *Costly government dividend and tax policies:* SOEs should share their profits with the government; however, excessive dividend payouts, dictated by budgetary needs, could have implications for SOEs' ability to operate. For example, Argentina's state-owned oil company, YPF, paid dividends of $602 million in 2016 despite incurring a loss of more than $1 billion that year.

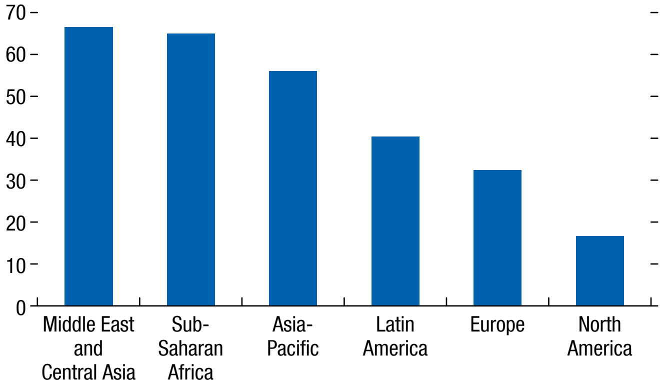
These challenges are particularly relevant in critical nonfinancial network sectors (power, water, ground transportation, energy) as well as in public banks. The rest of this section delves into these sectors.

Network Sectors: Special Challenges

Network industries, sectors in which a fixed infrastructure and a degree of standardization is needed to deliver the goods or services efficiently to end users, are critical for generating economic growth and achieving the Sustainable Development Goals. Safe water is essential for life and health. Reliable electricity saves businesses and consumers from having to invest in expensive backup systems. Affordable transportation underpins business activities and is key to generating

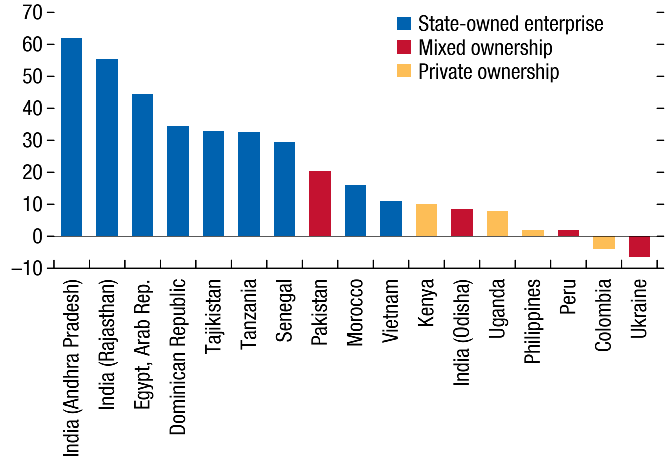
[7]Petri and Taube (2003) estimate quasi-fiscal activities in the energy sector at 26.7 percent of GDP in Azerbaijan in 1999 and 6.5 percent in Ukraine in 2000.

Figure 3.9. SOEs' Power Generation Capacity, 2017
(Percentage of total, by region)



Sources: S&P Global; UDI World Electric Power Plant database; and IMF staff calculations.
Note: SOEs = state-owned enterprises.

Figure 3.10. Gap between Costs and Electricity Tariffs
(Percent of total cost)



Source: World Bank 2019.
Note: Percent of total cost is the gap (the difference between total cost and the tariff) divided by total cost.

employment and advancing economic development. Thus, it is not surprising that the government intervenes in many of these industries, especially where the private sector has not begun operating.

SOEs dominate the power sector, especially transmission and distribution, given that these segments have characteristics of natural monopolies. Private investors are involved mainly in the generation of electricity, but SOEs are major players even there (Figure 3.9). In advanced economies, evidence is mixed on whether reforms, including privatization, delivered the anticipated efficiency gains (Gathon and Pestiau 1996, see Box 3.1). Government efforts to expand access and promote greater efficiency in power sectors in low-income developing countries have yielded mixed results. Access remains an urgent challenge—notable progress has been made, but 840 million people live without electricity, most in Africa.[8] Although private sector entrants contributed to expanding generation capacity, network expansion and access relied largely on SOEs. A common problem is the failure to achieve cost recovery (Figure 3.10). Below-cost tariffs reduce an SOE's capacity to invest—hurting access and growth—and weaken the financial situation of the firm.

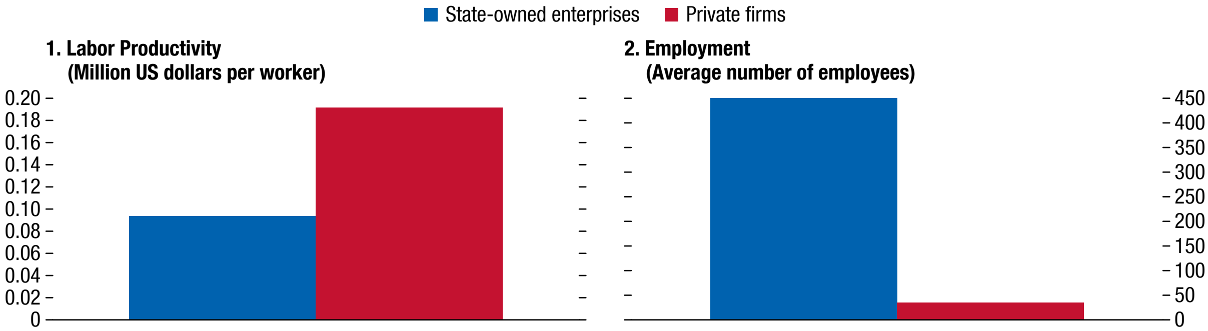
Specific features of the water sector also provide a rationale for government intervention (Menard and Peeroo 2011; World Bank 2004). Delivery systems require major investments in infrastructure, and potable water and adequate sewerage are essential for public health. Most countries have opted for a high degree of public provision through SOEs. Among advanced economies, public provision is dominant in the majority (for example, Australia, Germany, Japan, and the United States); only a few rely significantly on private providers (for example, Czech Republic, France, and England) (Pérard 2009). Recently, Paris (France), Berlin (Germany), and several US municipalities have remunicipalized water management (Warner and Aldag 2019).[9]

In developing countries, the challenge in the water sector is staggering. More than 2 billion people lack safely managed services, partly reflecting weak SOE performance (WHO and UNICEF 2017; World Bank 2004). The solutions are not easy but possible. There is growing awareness of the need for cost recovery, to ensure sustainability and improve service, while safeguarding provision to the poor. For example, in Burkina Faso, the public water utility has been instrumental in doubling the population's access to drinking water over the past two decades by introducing a progressive tariff grid (IMF 2015). In Mali, however, a private concession on water and electricity failed, despite having an independent regulator, owing to disagreement over the level of tariffs, political interference, and the government not paying its own

[8]See https://www.worldbank.org/en/news/press-release/2019/05/22/tracking-sdg7-the-energy-progress-report-2019

[9]Studies do not show significant performance differences between private and public provision of water; see, for example Perard (2009) and Suárez-Varela and others (2016).

Figure 3.11. National Oil Companies' Productivity and Employment



Sources: Orbis; Natural Resource Governance Institute; and IMF staff estimates.
Note: The sample includes 98 national oil companies and 1,520 private firms.

utility bills (Balance and Tremolet 2005; Estache and Wren-Lewis 2009).

Transportation is another crucial sector for economic activity and public well-being. The provision of public transportation, especially at the local level (trains, subways, buses), has involved significant government intervention justified by the need to ensure affordability as well as to address congestion, pollution, or accidents. Local SOEs commonly provide ground transportation in advanced economies, whereas informal private transportation services—often less safe and more polluting—are widespread in emerging market and economies. Allowing SOEs (or even private operators) to charge prices that cover investment and maintenance needs has proven challenging.[10]

Many oil-exporting countries have created national oil companies (NOCs) to exercise control over oil and gas exploration and garner potentially large profits for the state. However, NOCs are significantly less profitable and efficient than their private peers, partly owing to pressures from the government to engage in excessive hiring (Figure 3.11). Another issue is governments often have NOCs sell fuel at subsidized retail prices and undertake social spending. In some cases, NOCs take on most of the exploration of oil and gas, leaving governments with the costs and risks of exploration, instead of simply taxing profits. Moreover, the large profits create strong incentives for corruption (April 2019 *Fiscal Monitor*).

Are Public Banks an Appropriate Tool for Macro-Fiscal Management?

Government intervention in the financial system, including through public banks, is significant in many countries.[11] Although the presence of public banks—commercial banks that provide corporate and retail banking services to the general population and development banks that provide credit for development-related projects—has declined sharply since the 1990s as economic liberalization and financial globalization gained traction, they still have significant market share in several large economies.[12] State ownership of banks has been justified by the need to address market failures and promote economic development, although many banks also pursue profit maximization (see Box 3.2).[13] There is some recent renewed government interest in public banks, especially development

[10]For example, protests in Chile after a metro fare increase are in part rooted in the failed 2007 reform of the informal bus transportation system in the capital. The reform was intended to reduce congestion, pollution, and accidents through additional dedicated bus lines, modernization of the bus fleet, and fare integration with the metro (Gomez-Lobo 2012). The massive influx of passengers after the reform called for large investments that could not be covered by tariffs. The financial viability of the SOE operating the metro deteriorated rapidly, resulting in large direct subsidies from the government.

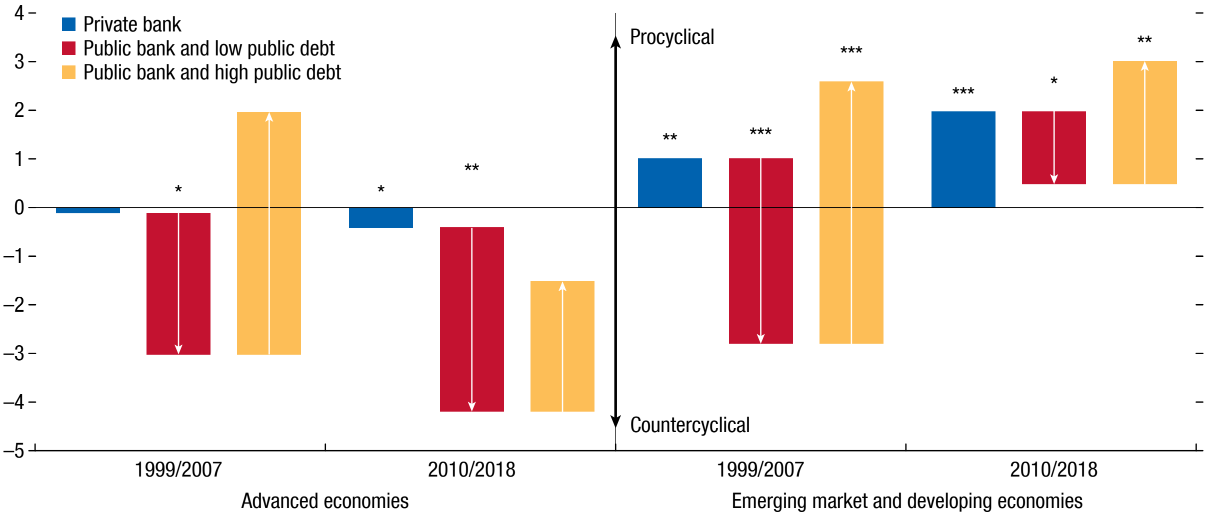
[11]This section focuses on public banks, but governments have also used SOEs in other financial areas, including insurance and mortgage markets (for example, in Canada and the United States, among many others).

[12]The global financial crisis led to a wave of large-scale recapitalizations and nationalizations of failing banks, notably in advanced economies, that has not been completely unwound (Igan and others 2019).

[13]On the role of public banks, see also Cull, Martinez-Peria, and Verrier (2017); Ferrari, Mare, and Skamnelos (2017); World Bank (2012); and Yeyati, Eduardo, and Panizza (2005).

Figure 3.12. Change in Loan Growth over the Cycle

(When GDP grows 1 percentage point above trend; percentage points)



Sources: Fitch Connect; and IMF staff estimates.
Note: Regressions control for several factors, including other bank characteristics (see Online Annex 3.3). Public banks are defined as banks with over 25 percent of equity owned by the government. Countries with high public debt are those above the 75th percentile of the distribution across the whole sample, roughly corresponding to 100 percent of GDP for AEs and 60 percent of GDP for EMDEs. AEs = advanced economies; EMDEs = emerging market and developing economies. ***, **, and * indicate statistical significance of the bars at the 1, 5, and 10 percent level, respectively. Bars indicate distance from zero for blue bar or preceding bars for the others.

banks, owing to their potential role in funding infrastructure investment.[14]

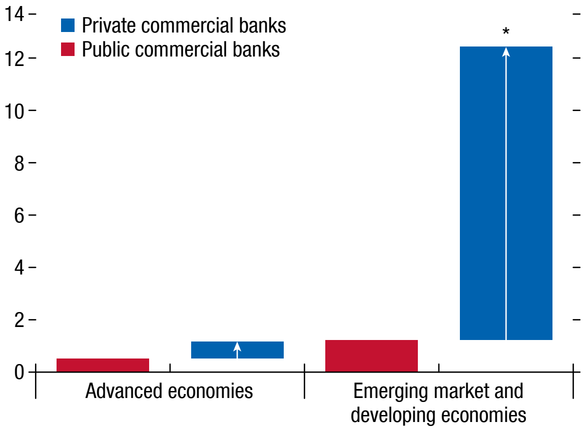
Governments also call on public banks to fight recessions. Public banks were used widely for this purpose during the global financial crisis, often financed by direct support from the governments' budgets (for example, loans or capital injections by Brazil, Canada, and India). Countries also raised credit ceilings of their public banks (for example, Finland and Korea) or issued special guarantees (for example, Mexico) for public banks to support key markets and firms (World Bank 2013).

There are, however, limits to the effectiveness of public banks in stabilizing the economy. Public bank lending has been less procyclical than private bank lending, on average, in the past 20 years but not in developing countries with high public debt levels (Figure 3.12). This different behavior likely reflects higher financing costs of and lower government subsidies to public banks in economies with tighter budget constraints. For example, in the case of the Brazilian development bank, BNDES, credit surged during the global financial crisis and for a few years during the strong postcrisis recovery but declined sharply during the recession of 2014–16, in part because soaring public deficits and debt closed the door on government lending to public banks (case study for Brazil, Online Annex 3.2). The quality of this rapid credit growth may not have been adequately assessed in the haste to extend credit, potentially leading to nonperforming loans in the future.

Public banks may also be used to fund the government and simultaneously receive support from the government. This sovereign-bank nexus potentially exacerbates the financial vulnerabilities of both (April 2019 *Global Financial Stability Report*; Dell'Ariccia and others 2018). Public banks tend to hold larger amounts of sovereign debt than do private banks, especially in emerging market and developing economies with higher public debt vulnerabilities (Figure 3.13). Moreover, during the sovereign debt crisis in Europe, domestic banks, particularly state-owned ones, were more likely to increase their holdings of domestic government bonds in fiscally distressed economies, suggesting a

[14]See, for instance, "National development banks are back in vogue" (*The Economist* 2019). Several new public development banks have been established since the global financial crisis, including PT Sarana Multi Infrastruktur in Indonesia (2008), Bpifrance (2012) and Société de financement local (2013) in France, the Development Bank of Nigeria (2013), and FinDev Canada (2017).

Figure 3.13. Bank Holdings of Government Bonds in Countries with High Public Debt
(Relative to countries with low public debt in percent of assets, 1999–2018)



Sources: Fitch Connect; and IMF staff estimates.
Note: The regressions control for several factors including bank characteristics (see Online Annex 3.3). Public banks are defined as those with more than 25 percent of equity owned by the government.
* indicates statistical difference from zero at 10 percent significance level.

"moral suasion" mechanism (Ongena, Popov, and Van Horen 2019). In India, government guarantees allowed public banks—even vulnerable ones—to expand credit during the global financial crisis with deposits moving from vulnerable private to "safer" public banks. However, the loan quality of these public banks soon deteriorated, increasing financial sector fragility and contingent liability risks for the government (Acharya and Kulkarni 2019).

Are SOEs Performing Efficiently?

Many governments demand that SOEs achieve their public mandates, perform efficiently, and compete with private firms. This section compares SOEs' financial performance with that of private firms and analyzes its determinants using data for about 1 million individual firms across 109 countries.[15] It also reviews evidence on governments' exposure to fiscal risks from SOEs.

SOE Financial Performance

A simple comparison reveals that profits and labor productivity are lower in SOEs than in private firms (Figure 3.14).[16] This finding is consistent with country or regional studies for China, Russia, and other countries in the Central, Eastern, and Southeastern European region (Abramov and others 2017; Lardy 2019; Richmond and others 2019). In part, this difference could reflect the cost of public mandates—for example, providing services at below-cost prices to underserved communities or promoting employment beyond what is efficient for the firm—but other factors may be at play. It is important to note that if the differences are because SOE's are less efficient, the resulting misallocation of resources can reduce economywide productivity (Song, Storesleten, and Zilibotti 2011).

The Role of Economic Sectors and State Ownership in SOE Performance

SOEs' performance gaps may reflect differences in the sectors in which they operate or in ownership. Cross-country evidence shows that SOEs are less productive than private firms in the same sectors[17] and that the productivity gap tends to be larger in sectors where there is usually more competition (for example, agriculture and manufacturing). In some of the regulated sectors (such as utilities), the gap is lower (Figure 3.15).

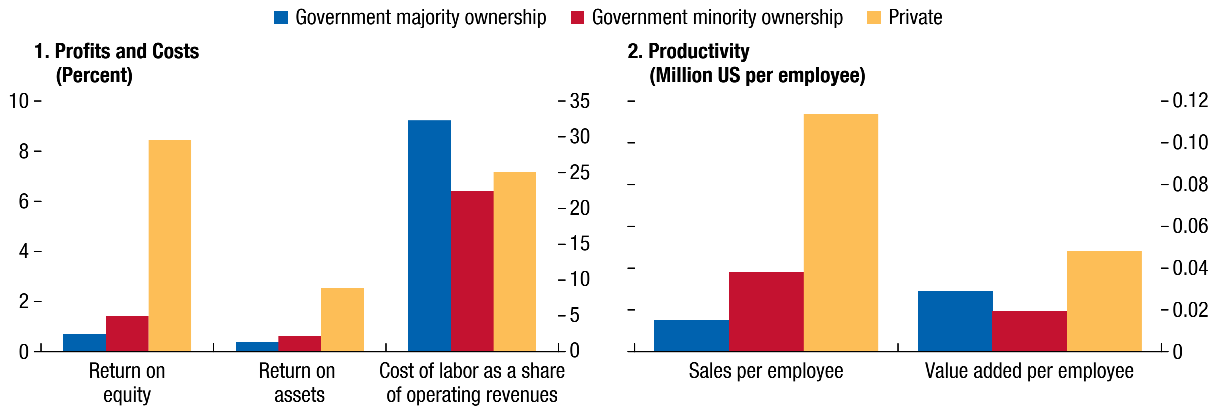
Mixed ownership also makes a difference in firm performance. Private owners put greater emphasis on profits and efficiency. Listed mixed-ownership enterprises are subject to greater monitoring by private investors and analysts (Biglaiser and Brown 2003; D'Souza, Megginson, and Nash 2005; Pargendler, Musacchio, and Lazzarini 2013). The evidence confirms that partial involvement of the private sector is beneficial (Megginson and Netter 2001; Vining and Boardman 1992). The analysis in this chapter indicates that firm productivity is lowest when the government has a majority position—private firms are three times more productive—but the gap is narrower when the government has a minority position (Figure 3.16).

[15]Of the 969,000 firms in the sample, about 949,000 are fully private, 15,000 are majority state owned, and 4,000 are minority state owned. The database includes mainly firms from advanced and emerging market economies with a smaller sample from low-income countries. The results are robust when constraining the analysis to countries where the coverage of firms is high. See Online Annex 3.4 for details.

[16]The analysis is based on SOE financial data, given that it is available for a large set of firms. For example, labor productivity is proxied by sales per employee, which does not necessarily only reflect differences in technical efficiency. If SOEs are restricted to charging lower prices relative to private firms, this would have a negative effect on sales per employee.

[17]The results in this section are similar for other performance measures. See Online Annex 3.4.

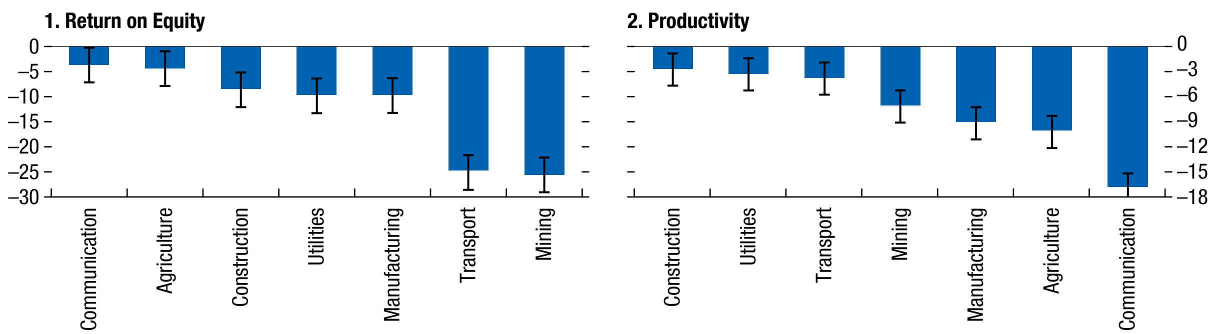
Figure 3.14. SOEs' Performance Relative to Private Firms



Sources: Authorities' annual reports on SOEs; Natural Resource Governance Institute; Orbis; and IMF staff estimates.
Note: The panels are based on median values. Weighted averages show a similar pattern. SOEs = state-owned enterprises.

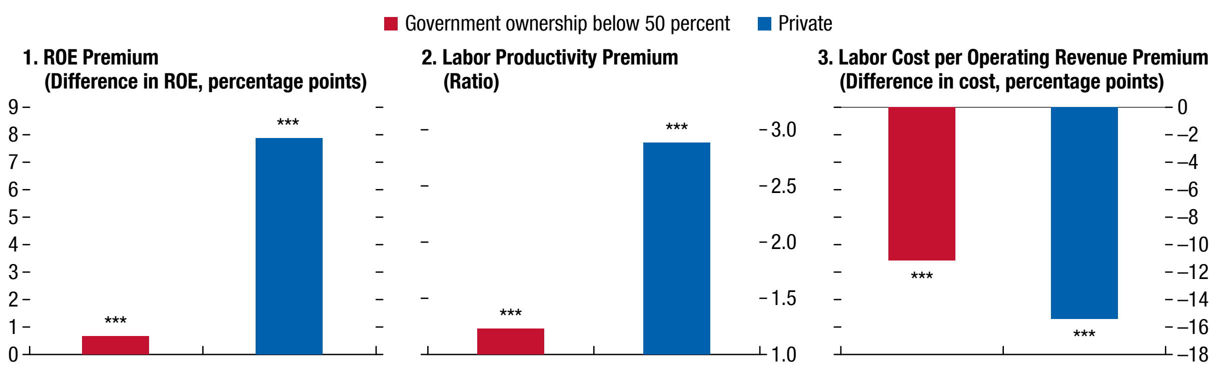
Figure 3.15. Relative Performance of SOEs, by Sector

(Percentage point difference in SOEs performance relative to private firms)



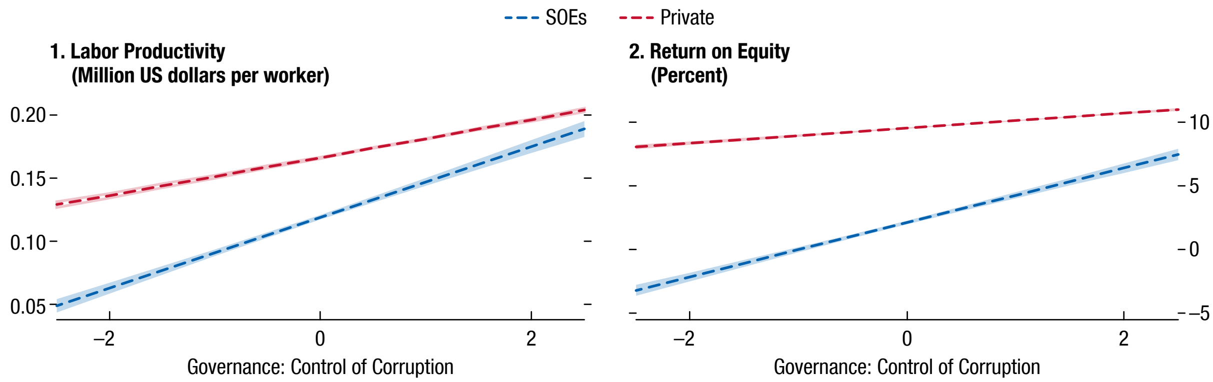
Sources: Authorities' annual reports on SOEs; Natural Resource Governance Institute; Orbis; and IMF staff estimates.
Note: For productivity (sales per employee), sales data are based on 2017 prices. SOEs are firms with 50–100 percent public sector ownership. Data are from 1999 to 2017. SOEs = state-owned enterprises.

Figure 3.16. Degree of State Ownership and Firms' Performance



Sources: Authorities' annual reports on SOEs; Natural Resource Governance Institute; Orbis; and IMF staff estimates.
Note: The panels show the performance of firms depending on the degree of state ownership and controlling for other factors. "Minority ownership" means that the government owns less than 50 percent of the company; "majority ownership" means that the government owns 50 percent or more. For productivity (sales per employee), sales data are based on 2017 prices. Data are from 1999 to 2017. The coefficients are relative to firms with government majority ownership. ROE = return on equity; SOEs = state-owned enterprises. *** indicate statistical difference from zero at 1 percent significance level.

Figure 3.17. Governance and Firms' Performance



Sources: Authorities' annual reports on SOEs; Natural Resource Governance Institute; Orbis, World Bank, Worldwide Governance Indicators; and IMF staff estimates.
Note: The panels illustrate the effect of control of corruption on firms' performance depending on the type of ownership. SOEs are firms for which the government owns 50 percent or more. The analysis controls for firm-specific characteristics, country-specific variables, and sector where the firm operates. The Control of Corruption Index provides a relative measure of perceived corruption. Data are from 1999 to 2017. SOE = state-owned enterprise.

There are also significant differences for return on equity, labor costs, and other measures of performance. Empirical studies on privatization complement these results (see Box 3.1).

Good Governance Is Critical

Weak governance in government harms all firms but has an especially deleterious effect on SOEs (Baum and others 2019). This subsection reports on the relationship between financial performance and a measure of countrywide perceived governance (control of corruption), controlling for the level of development and other factors.[18] The results show that as countrywide perceived governance improves, SOEs' performance and productivity gaps relative to private firms shrinks (Figure 3.17). SOEs that operate in countries with high levels of perceived corruption are one-third as productive as private firms, on average; in countries with strong governance, the productivity gap is 7 percent. Regarding profitability, the gap with private firms declines but remains significant—a difference of 4 percentage points in return on equity between SOEs and private firms in countries with good governance scores—which may reflect, at least in part, unfunded public mandates.

One possible driver of performance across different degrees of governance is the sector in which the SOE operates. Countries with better governance scores seem to be more selective, having SOEs in specific sectors, especially utilities and transportation, in which there is a stronger reason for intervention and the performance of SOEs is closer to that of private firms. These countries have fewer SOEs in areas in which private firms have significantly superior performance (for example, manufacturing).

Fiscal Costs and Risks to the Government

SOE performance and the realization of fiscal risks from SOEs can significantly affect public finances. Over the years, governments have provided significant support to financial SOEs (mainly capital injections) and nonfinancial SOEs (predominantly recapitalizations and debt assumptions), with the maximum annual support to financial and nonfinancial SOEs reaching 18 and 16 percent of GDP, respectively (updated version of database by Bova and others 2016).[19] SOEs that operate in the airline, banking, mining, railway and utility sectors are among those that required costly support. For example, Italy's national airline is under bankruptcy protection and has received large loans or transfers from the government

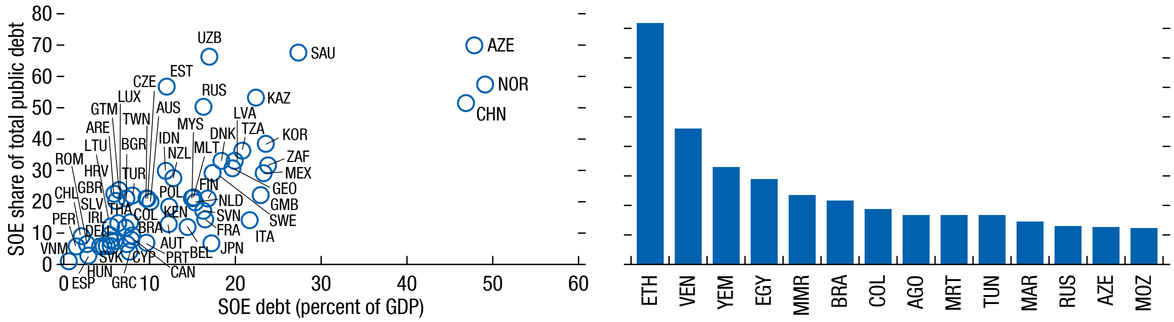
[18]The Control of Corruption index from the Worldwide Governance Indicators (WGI), available since 1996, aggregates information from more than 30 different sources. Caution is needed in interpreting scores for any individual country given measurement error because the quality of underlying data can vary across countries and data sources.

[19]Governments have also provided significant support to private financial institutions and nonfinancial companies, most noticeably during the global financial crisis.

Figure 3.18. SOE Debt Vulnerability

1. Nonfinancial SOE Liabilities (Percent of GDP)

2. External SOE Debt (Percent of exports of goods and services)



Sources: IMF's Public Sector Balance Sheet (PSBS) database; Eurostat; S&P Capital IQ; and IMF staff calculations.
Note: Debt drawn from S&P Capital IQ is only for the largest SOEs in the country. S&P Capital IQ and Eurostat data are for 2017 or 2018. Debt data drawn from the PSBS database covers a range of years from 2012–2016 and, for some countries, represent total liabilities less equity. Data labels in the figure use International Organization for Standardization (ISO) country codes. SOE = state-owned enterprise.

Sources: World Bank 2020; WEO 2019; and IMF staff calculations.
Note: The figure includes both financial and nonfinancial SOEs. Data labels in the figure use International Organization for Standardization (ISO) country codes. SOE = state-owned enterprise.

in the past few years.[20] Similarly, South Africa's government-owned power company, Eskom, is receiving a rolling government bailout of 2⅓ percent of GDP over three years, although the cost may turn out larger (IMF 2019b). In Belarus, over the past years, the government on average provided 1½ percent of GDP in subsidies and about 2 percent of GDP in additional off-budget support (Richmond and others 2019).

More broadly, SOE debt levels can pose a risk to public sector finances, even in the absence of explicit government guarantees. In some countries, debt of the SOEs exceeds 20 percent of GDP and in several cases constitutes half or more of the public sector debt stock (Figure 3.18). In other countries, SOE external debt exceeds 25 percent of the countries' exports of goods and services (see also IMF 2020). Even if the debt was incurred to develop a natural resource, as in oil-exporting countries, the debt may increase the vulnerability of the government to shocks (for example, a fall in oil prices). In addition to debt, SOEs may have significant obligations to private parties through joint ventures, public-private partnerships, and power purchase agreements.

The realization of SOE risks may also have multiplier effects on the whole economy. When these risks materialize in public banks, credit growth may be curtailed, undermining economic activity. As for nonfinancial SOEs, the larger they are the more significant the impact of their financial imbalances can be for employment and investment. If financially impaired SOEs dominate a key economic sector such as power, they can also affect the financial system and competitiveness (for example, Ghana, see Online Annex 3.5). The public sector balance sheet approach can be used to show how a macroeconomic shock can have cascading effects through interrelationships between financially vulnerable SOEs (for example, in The Gambia) to the national budget (October 2018 *Fiscal Monitor*).

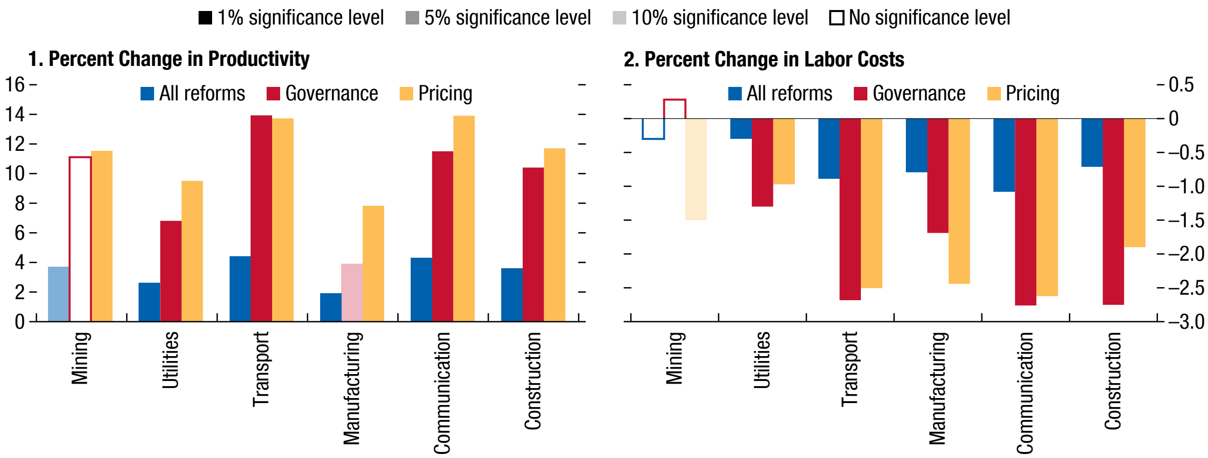
Reforms Can Help

The discussion so far suggests that there is scope for SOE reforms targeting governance and financial incentives to improve SOE performance. Some empirical cross-country evidence, although limited, indicates that SOE reforms can improve their efficiency (Megginson and Netter 2001). Taking advantage of a novel database for a sample consisting primarily of emerging market and developing economies, as well as a few advanced economies (members that had IMF-supported programs in 2002–17), we study the effect of SOE reforms in a cross-country setting.[21]

[20]Alitalia was privatized in 2009, but in 2014 the government took a minority stake. In 2017, the airline was put under special administration. In 2020, the company was formally reincorporated as a public holding.

[21]The information comes from data on structural conditionality in the context of IMF-supported programs. See Online Annex 3.6 for details.

Figure 3.19. Impact of SOE Reforms, 2002–17



Source: IMF staff estimates.
Note: "All reforms" includes the impact of financial target setting and arrears clearance in addition to governance and pricing reforms. "Pricing" includes, among others, implementation of automatic fuel prices and electricity tariffs adjustments. The coefficients measure the impact of SOE reforms on average productivity and average cost changes. The coefficients can be interpreted as the average improvement of productivity or costs following reforms. SOE = state-owned enterprise.

The reforms target (1) SOE governance (for example, SOE management, oversight, and transparency)—not governance in general; (2) public enterprise pricing (such as tariffs and automatic fuel price mechanisms); (3) arrears clearance; and (4) the achievement of specific financial targets.

The results show that some reforms positively affect financial performance.[22] Reforms of SOE governance and pricing improve financial variables for all sectors except for mining SOEs (Figure 3.19). For example, an implemented governance reform is associated with an increase in productivity of $10,000 per worker and a reduction of costs of 5 percent in the electricity sector. Reforms such as arrears clearance and financial targets have weaker or no impact, perhaps reflecting that if other structural reforms are not part of the package the underlying factors driving performance may not change.

These reforms require building and sustaining broad popular support over several years. It is also important that improvements in the financial health of SOEs be achieved while protecting the more vulnerable segments of the population from possible adverse effects. Jordan's and Ukraine's experiences provide two examples.

- Subsidies to Jordan's electricity company, NEPCO, were close to 6 percent of GDP in 2014 (for context, the share of total health spending was 7.5 percent of GDP in the same year). NEPCO undertook a series of reforms, including gradual tariff adjustments since 2012 and the installation of a liquefied natural gas plant to ensure cheaper inputs. At the same time, vulnerable households were supported by increased cash transfers. As a result, public transfers to NEPCO were eliminated as of 2015, and NEPCO has posted small positive or negative net operational balances since 2016.
- Ukraine's national oil and gas company, Naftogaz, turned from a loss-making firm receiving significant budget aid to a profitable company within a few years. Significant gas and heating price increases, along with restructuring and governance reforms as of 2014 were accompanied by the extension of utility subsidy programs for vulnerable households.

In both countries, ongoing efforts will be needed to sustain the reforms, including targeted support to the most vulnerable and continued efficiency gains.

[22]SOE reforms are implemented SOE reforms during IMF-supported programs. Governance reforms span a wide array of reforms related to monitoring, auditing, and management; structural reforms to a sector as a whole (if they are governance related); and others. Public enterprise pricing reforms primarily concern tariff structures and typically target SOEs in electricity, gas, oil, heating, and water sectors.

How to Get the Most Out of SOEs

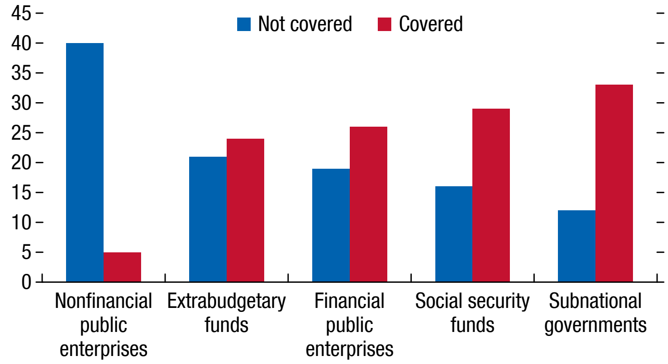
As the previous sections illustrate, SOEs can be difficult to manage and costly to the budget and the economy. This is particularly true when they are subject to excessive political interference and are used as vehicles to disguise off-budget spending and borrowing, patronage, or corruption. This section explores what countries can do to overcome these and other challenges and get the most out of SOEs. Although SOEs exist for many reasons, including historical and political circumstances, it is important to regularly review whether the rationale for each SOE remains valid and whether it delivers value for taxpayers' money. Given the potentially large costs, countries should use SOEs selectively and only where government intervention through SOEs can be most effective. The case is weaker for SOEs that operate in competitive sectors because private firms provide goods and services more efficiently. In contrast, experience suggests a stronger case for public intervention in sectors in which the government strives to achieve universal delivery of goods and services at affordable prices (for example, public utilities and ground transportation)—this is an area where SOEs are heavily present around the world.

For their SOEs to be successful, many countries will need to strengthen the link between SOEs and public sector goals, improve firm-level incentives, and enhance governance institutions. Some countries, for example, the Nordics (Online Annex 3.7), have built strong SOE frameworks that encompass these elements with the aim of ensuring they deliver value for taxpayers' money.

Aligning SOE Activities with Public Sector Goals

Consistency between SOE activities and general government policies is important to prevent the two parts of the public sector from working at cross purposes. For example, if SOEs accumulate significant debt when the rest of the public sector is aiming at fiscal adjustment, the government's efforts to reduce its borrowing costs may be undermined. Coverage of SOEs in the public accounts and provision of the right incentives for SOEs allow for better alignment of SOE actions and performance with overall government objectives.

Figure 3.20. Fiscal Coverage beyond the Central Government in Sub-Saharan Africa
(Number of countries)



Source: IMF staff survey of 45 countries in sub-Saharan Africa.

Consistency with the Broader Public Sector Goals

SOE financial operations and assets and liabilities should be fully integrated into the financial statements of the public sector. Applying such a public sector balance sheet approach would enhance transparency of SOE financial performance and relations with other parts of the public sector (October 2018 *Fiscal Monitor*). Some countries or regions already implement a public sector balance sheet approach (Australia, New Zealand, United Kingdom) or partially reflect SOEs' main financial indicators in the public accounts (for example, Latin America). But many others do not, as is the case in sub-Saharan Africa (Figure 3.20) and most of Europe.[23] Fully integrating SOEs into a public sector accounting framework will likely require an incremental approach in some countries. In the meantime, countries that currently report information only on central or general government fiscal results (revenue, expenditures, budget balance, and debt) should complement this reporting with memorandums that summarize government guarantees to SOEs (in addition to the recommended SOE financial disclosure practices outlined in the transparency section below).

Given that SOEs use public resources and pursue policy goals, it is important to ensure that they collectively operate consistently with the country's broader macro-fiscal objectives. Those objectives are often embedded in fiscal targets, such as the overall budget

[23]Based on IMF's Fiscal Transparency Evaluations since 2014, around 90 percent of the countries evaluated did not publish comprehensive information on the public sector.

balance or gross debt, that are set at levels to support macroeconomic goals—economic growth, inflation, and stability. Including nonfinancial SOEs in the fiscal targets would create greater incentives for fiscal discipline and transparency because (1) governments will likely exercise greater oversight over SOEs' overall borrowing and (2) governments' options to circumvent fiscal targets would be more limited. Inclusion would ensure that the broader fiscal policy goals are consistent across the public sector, for example, in keeping total public debt at safe levels.

The preference is to include nonfinancial SOEs in fiscal targets. Many governments in Latin America already include most nonfinancial SOEs in the fiscal targets and rules. At a minimum, governments should ensure comprehensive coverage in fiscal targets of at least nonfinancial SOEs that pose significant fiscal risks and for which the government is a majority shareholder (IMF 2007).[24,25] If this is not feasible, an SOE's debt should be included in public sector debt when the SOE poses a fiscal risk.

When considering the need for macroeconomic stabilization, it is appropriate to limit the use of SOEs and use more direct, transparent measures instead. Using SOEs to support employment during economic downturns is less efficient than monetary or fiscal policy tools. Likewise, forcing public banks to boost credit as the economy weakens could ultimately deteriorate the quality of their loan portfolio and increase risks. A case could be made for using public banks in situations of severe economic deterioration as part of a broader, and exceptional, policy action (as during a major global financial crisis). This approach requires fully transparent objectives and costs.

[24]SOEs have public mandates that imply that their finances and operations will likely deviate from commercial interests making the commercial orientation of an SOE ill-suited as a selection criterion. Past analysis by IMF staff finds that SOEs did not behave commercially because there was always some government-imposed mandate or constraint (for example, on setting prices or employment policies) (IMF 2005).

[25]Public banks are better kept outside fiscal targets given the nature of their financial operations. It is also important to keep close track of the performance of SOEs that routinely turn profits—as might be the case, for example, for a highly profitable national oil company—to ensure that such SOEs remain efficient and to recognize that such profits will ultimately accrue to the state. The case for inclusion of such SOEs in the fiscal targets needs to be counterbalanced against the possibility that they could obscure the underlying financial performance of the rest of the public sector.

Getting Incentives Right at the Firm Level

Governments must give SOEs the right incentives to deliver value for taxpayers' money. This is more challenging, but also more necessary, when SOEs operate in sectors with limited competition or when there are significant externalities (for example, when provision of a good is important for economic growth) or social mandates. To promote efficiency and a sustainable business model,

- *Getting the pricing policy right is key.* Pricing rules should be transparent and depoliticized (for example, published rules specifying how domestic fuel prices will adjust automatically to changes in the cost of supplying fuel). Preferably, prices should be set to ensure cost recovery (including to cover investment expenditure). The pricing policy in sectors with negative externalities (for example, fossil fuels that lead to pollution and health problems) should also be adjusted, protecting more vulnerable households.[26] If this is not possible—for example, because a large share of the population is poor and there is no social safety net—governments should appropriately compensate the SOE in a timely and transparent manner. Conversely, it is important to prevent excessively high prices if the SOE has monopoly power because high prices may lead to inefficiencies.
- *Independent regulatory agencies* need to balance different interests, ensuring that government and firms operate according to transparent and well-defined rules, especially when private investors are involved. For example, regulators can ensure tariffs in public utilities are set to balance affordability with the need to cover costs. In low-income countries, pooling resources in a single regulator overseeing several sectors can help build capacity.
- *Professional managers and the independence of managerial decisions are required to ensure the firm operates efficiently.* Firms need to have corporate governance structures that promote sound hiring, wage, and procurement policies. The next section discusses in greater detail some of the important features, including a professional board and a high degree of transparency.

[26]In some cases, a better approach would be to have a broader strategy, under which firms can charge prices that reflect costs with the government directly providing subsidies to the poorest households.

Other strategies that have been adopted to improve the SOE incentives include corporatization and allowing for participation of private minority shareholders. In OECD countries, most SOEs are incorporated according to company law and are generally subject to the same laws and regulations as private companies.[27] About half of those companies by value are listed on a national stock exchange (OECD 2017). Mixed ownership has been adopted by many countries to some degree over the past decades (for example, Brazil and China as well as European countries).

Strengthen Institutions

The starting point is a clear and comprehensive ownership policy aiming to get value for taxpayers' money out of SOEs (Allen and Alves 2016). Ownership policies should clearly state (1) the mandates, objectives, and a dividend policy for SOEs; (2) the approach to achieving professional boards of directors; (3) the functions carried out by the government as owner of the SOE and its coordination with fiscal risk oversight functions; and (4) the way the government exercises its ownership rights. To assess SOEs' effectiveness in achieving value for money, it is also important to distinguish and disclose commercial and noncommercial activities (policy mandates). Moreover, governments must develop the capacity to properly oversee the operations of the company while avoiding excessive intervention of public officials; enforce transparency requirements; and establish a sound SOE corporate governance framework. Implementation of anticorruption strategies to prevent the use of SOEs for private gain is also critical.

Effective Financial Oversight and Ownership

A strong oversight and control agency can yield better performance from SOEs (Musacchio and Pineda Ayerbe 2019). A centralized model provides the best potential for ensuring consistency between the ownership (for example, representation on company boards, strategic direction of firm) and financial oversight functions. A centralized model could take the form of an autonomous agency or holding company (as in Finland, France, Kenya, Malaysia, Peru, and Singapore). Holding companies exhibit advantages when managers have professional expertise and they protect SOEs from undue political interference.

It is critical to have one government unit responsible for the financial oversight of SOEs even when a holding company is in place. One unit makes oversight activities more coherent, while pooling experts from different areas. A central element of the oversight function is to identify, disclose, and mitigate fiscal risks. Fiscal risk assessments can be made for individual companies and for the SOE portfolio. The latter allows for evaluation of the combined risks for the government.[28] Oversight units can be located within ministries of finance (France) or public companies (such as UK Government Investments). The former model has the advantage of better integrating SOE risk oversight in the budget process and facilitating a broader assessment of fiscal risks. Moreover, SOE oversight units should be accountable to an institution representing the interests of the public (for example, parliament).

SOEs' investment plans, because of their direct fiscal costs and impact on growth, deserve special scrutiny. Government assessment of large investment (infrastructure) plans of SOEs should be informed by technical and economic appraisals based on standardized criteria. Furthermore, when projects involve direct budgetary costs—for instance through capital injections or on-lending to SOEs—they should be subject to a selection process to ensure the consistency of aggregate investment plans with medium-term fiscal objectives and the degree of fiscal risk. The effectiveness of the process requires close cooperation among the ministry of finance, SOEs, and line ministries, who are often tasked with the design of sectoral investment strategies. However, line ministries should not be given excessive control over ownership arrangements or strategic decisions because this might undermine SOE efficiency.

Several approaches exist to contain potential risks from the SOE sector. One possibility is to explicitly commit to a no-bailout clause. This approach has been used mostly in transition countries, such as Poland and Ukraine. A recommended approach is to subject SOEs to effective insolvency procedures such as those for private firms. For example, bankruptcy legislation in Italy, Korea, the Netherlands, Sweden, and the United Kingdom has the same insolvency procedures for SOEs as

[27]At the same time, company laws do not specifically address the relationship between the state and SOEs. The legal framework for SOEs must therefore consist of an additional layer, that could be an SOE law, that governs such a relationship.

[28]IMF staff have supported the development of SOE risk analysis templates in several countries during the past decade, most recently in Armenia (2015), Namibia (2018), and Serbia (2019).

for private companies.[29] Providing SOE management with incentives to manage risks (such as performance contracts and benchmarking) can help too. However, the latter approach is often difficult to implement.

Countries should also regularly review their SOE portfolios to assess whether the policy case for an SOE remains valid. For example, technological changes may mean the reason for the government intervention no longer exists (for example, it is possible that competitive mobile phone networks have undermined the need for state ownership in telecommunications). Several European countries conduct these reviews, either periodically or on an ad hoc basis (such as when a need arises to analyze an SOE). For example, Germany conducts a biennial review of its SOE portfolio during which each SOE's continued existence must be justified (OECD 2018a). In general, if the SOE is no longer relevant, options for freeing government resources for better uses include (1) selling the assets and closing the firm—with appropriate protection to workers and communities—if the business plan is not viable, and (2) privatizing the firm if the appropriate institutional preconditions are in place and the business plan is viable (Box 3.1).

Transparency

The financial and operational performance of the SOE along with its financial relations with the government must be disclosed. This can reduce the likelihood that SOEs will be used as vehicles for off-budget spending and borrowing, political patronage, or corruption. Unfortunately, financial information on SOEs in many countries is sparse. This is especially the case for NOCs, which manage large assets, particularly in the Middle East and sub-Saharan Africa (NRGI 2019).

Disclosure of SOE financial statements is the prevailing practice in advanced economies, whereas in emerging market economies disclosure is often restricted to listed SOEs. SOE financial statements should be audited by the national audit office or private audit firms approved by the national audit office. Finland, France, Ireland, New Zealand, and Sweden also publish performance assessments of at least their largest SOEs.

An annual report with detailed information and analysis of the performance of the SOE sector at the aggregate, sectoral, and company levels can be an effective communication tool. Countries such as India, Paraguay, the Philippines, and Sweden publish reports on the aggregate performance of the SOE sector. Brazil, Ghana, India, Korea, and Sweden also provide information at the individual SOE level. As highlighted earlier, ultimately, SOE financial data should also be integrated into a public sector balance sheet to provide a comprehensive view of the public finances.

Transparency is also needed on the financial interactions between the general government and SOEs. Government mandates to SOEs should be clearly defined, transparently disclosed in the budget, and compensated if needed.[30] Fiscal risks associated with SOEs, both at the public sector level and at the firm level, when relevant, should be regularly reported (including contingent liabilities). The assessment of SOE risks and the mitigation measures should be disclosed. Fiscal risk statements are a good vehicle for doing this, as in Austria, Georgia, and the Philippines. In South Africa, the budget review discloses the financial position and prospects of the largest loss-making nonfinancial SOEs (in addition to other SOEs) and describes ongoing risk mitigation measures.

SOE Corporate Governance

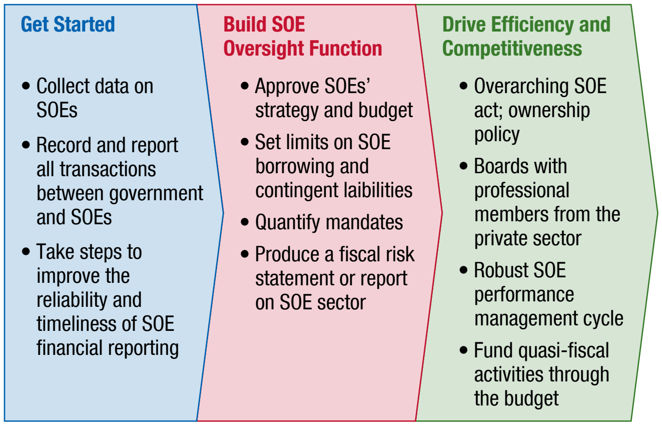
Governments should establish and enforce SOE corporate governance standards in line with good international practice.[31] The composition of SOE boards plays a significant role in the quality of corporate governance. At a minimum, governments should promote professional boards that can help ensure proper accountability. In some countries, some or all of the members of the boards of directors are required to be independent of the government (for example, Canada, Germany, the Netherlands, and Switzerland). Appropriate regulation of SOEs is another important element of corporate governance. In Chile, the Netherlands, Norway, and Sweden, at least the largest SOEs are subject to the same regulatory framework as listed private companies. A third attribute of good corporate governance is regularly assessing SOE management performance. This can be difficult but is possible. For example, New Zealand has a sound and effective performance contracting framework within which SOEs' goals are informed by risk oversight

[29]However, in some cases, countries still shield the firms from bankruptcy invoking national interest.

[30]The IMF's *Fiscal Transparency Handbook* recommends the disclosure of quasi-fiscal activities, including the rationale for undertaking them through SOEs rather than through the budget and the mechanisms used to compensate SOEs for any resulting deterioration in their financial positions.

[31]The OECD Guidelines on Corporate Governance of SOEs (OECD 2015) are an example of good standards.

Figure 3.21. Gearing SOE Oversight to Capacity



Source: IMF staff.
Note: SOE = state-owned enterprise.

and fiscal objectives. Implementing high corporate governance standards remains challenging in many low-income developing countries.

Transition to Better Oversight and Management of SOEs

Implementing a system for overseeing SOEs that meets all the requirements discussed previously takes time and resources. Some of these reforms may not be possible in the short term in low-capacity countries. In such cases, this argues for a risk-based and sequenced approach to building an oversight regime for SOEs with a focus on monitoring mainly SOEs that involve higher risks.

Figure 3.21 illustrates the three main pillars of reform. First, governments need to know their SOEs, as many countries do not have a firm grasp of the number or size of the SOEs they own. This will also allow regular reviews to determine which SOEs are still relevant. The second pillar focuses on building oversight with a strong emphasis on controlling fiscal risks. Third, policies and procedures need to incentivize government officials and SOE boards and management to strive for SOE efficiency. In some cases, it may be possible to pursue elements of different pillars simultaneously. The feasibility and speed of reforms will depend on country circumstances, including political economy considerations.

Being a Good "Global Citizen"

As SOEs have grown in scope and size, their drawbacks have spilled over to other countries, leading to calls for protectionist measures. As discussed previously, concerns that government support can provide SOEs with competitive advantages are growing.[32] As such, SOEs' activities may distort international markets (for example, aluminum, semiconductors, airlines, and steel), including when they are shielded from foreign competitors in their domestic markets. Another concern is that SOE expansion abroad is not always based on commercial objectives but may reflect other home country goals, such as control of natural resources, acquisition of technology, or political or diplomatic objectives. Moreover, SOEs are a major conduit for foreign bribes, with available data suggesting SOE officials received 80 percent of total bribes in foreign bribery cases (OECD 2014). SOEs in the power sector (generation of electricity) account for a substantial quantity of greenhouse gases (OECD 2018c), more than their private peers, and NOCs can have a significant impact on the environment in countries where they operate (for example, by polluting water or abandoning oil fields without cleaning them). Addressing these drawbacks can deliver domestic and global benefits.

The main benefits are domestic. Well-governed, transparent, and efficient SOEs that compete on a level playing field support productivity growth, better use public resources, and reduce local pollution. These benefits could also generate positive spillovers to other countries. Indeed, SOEs can play their part in the pursuit of global public goods, such as protecting the environment (for example, by moving toward cleaner sources of energy in the power sector, or by minimizing environmental damage when conducting oil and gas exploration). Likewise, SOEs can play a positive role in the global fight against corruption if governments improve general governance at home and impose effective anticorruption strategies, including when SOEs operate abroad.[33] Multilateral efforts would complement these domestic reforms.

Some advanced economies have taken steps toward fostering a level playing field

[32]The legal framework for state aid in the European Union provides an example of how some of the concerns could be addressed. It also contains a working definition: government support is a concern if it confers an advantage to certain firms and the advantage is selective, distorts competition, and affects trade between member states.

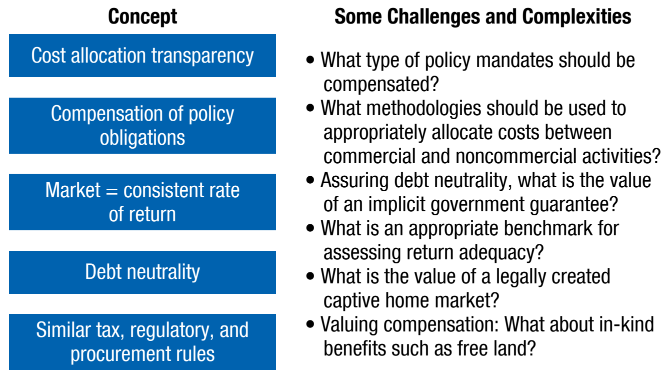
[33]Similarly, source countries need to enforce legislation against foreign bribery (as envisaged, for example, under the OECD anticorruption convention—see April 2019 *Fiscal Monitor*) to prevent their private firms from paying bribes to foreign SOE officials.

(i.e., competitive neutrality).[34] The EU and Australia have some of the most comprehensive approaches. For example, Australia requires SOEs to make compensatory payments to the national treasury for regulatory or debt-financing advantages (OECD 2016b). Other advanced economies have made a commitment to competitive neutrality, and most have laws and regulations that address potential uneven treatment of SOEs and private firms (OECD 2018a). Several countries have sought to address some elements of competitive neutrality across borders.[35] Multilateral institutions have also established disciplines (World Trade Organization) or guidelines (OECD 2015) that touch on the issue of competitive neutrality to varying degrees.

A more cooperative solution would be a multilateral agreement on general principles to ensure a level playing field between SOEs and private firms. These principles would guide SOE international behavior and recipient-country responses, which would build mutual trust. An approach akin to the Santiago Principles for sovereign wealth funds (International Working Group of Sovereign Wealth Funds 2008) may be worth considering, with appropriate adaptation to SOEs. The principles could cover areas such as transparency on mandates and the type and size of government support. They could also promote nondiscriminatory treatment. Adoption of the principles could be voluntary, at least initially.

Establishing effective principles would require significant technical work and political desire across countries. Detection and satisfactory resolution of SOE competitive advantages requires information that is frequently lacking on explicit and implicit government support for SOEs, the cost to the SOE of its

Figure 3.22. Competitive Neutrality: Some Basics



Sources: OECD 2018a; and IMF staff.

noncommercial mandate (if any), SOE and comparator company finances, and the broader regulatory and legal environment in which the firms operate. Figure 3.22 highlights some of the issues that would need to be addressed to foster competitive neutrality. For example, the costs of an SOE's commercial and noncommercial mandates would need to be identified, separated, and disclosed, using a methodology to be agreed upon. Another important aspect would be to ensure that an SOE's cost of capital (interest on debt and return on equity) is similar to its private sector competitors, which would require benchmarking competitors' costs of capital and requiring the SOE to make compensatory payments to the budget if the SOE's cost of capital is lower than the benchmark. Challenges to establish common methodologies can be overcome, and an agreement on common principles would yield benefits domestically and globally by supporting trade and foreign direct investment.

Conclusion

SOEs have major economic and fiscal effects in many countries. SOEs are among the largest companies in the world and are now global players. At the same time, many SOEs are struggling. SOEs generally have low productivity, distort competition, and can be plagued by corruption. SOEs have fallen short, particularly in developing countries, in providing basic services, such as access to safe water, sanitation, and reliable electricity, to the entire population. Many have been a significant drain on the government budget and in some cases have contributed to economic and fiscal crises. Concern about the activities

[34]Competitive neutrality is usually defined as a situation in which no entity operating in an economic market is subject to undue competitive advantages or disadvantages (OECD 2012; UNCTAD 2019). Competitive neutrality concerns are not limited to SOEs; they may also apply to nonprofit entities that are active in the marketplace or to private entities receiving government support.

[35]For example, the Australia–United States Free Trade Agreement contains specific obligations on anticompetitive practices by SOEs. At the sectoral level, recent agreements between the United States and several Gulf countries and a revised EU directive on airline competition (EU 2019) have sought to address concerns about unfair SOE competition in the global airline industry. At the regional level, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, the agreement between the EU and Japan for an economic partnership (EU-Japan EPA), and the agreement between the United States, Mexico, and Canada each contain a chapter on SOEs that establishes rules to promote fair competition and prevent market distortion by governments.

of multinational SOEs is growing, which could fuel protectionist measures.

The model for using and managing SOEs should be strengthened in many countries. The stakes are high because SOEs provide core economic services and could be an important vehicle for achieving the Sustainable Development Goals. International experience provides lessons on how to move foward. Governments should not waste public resources in areas where intervention is not needed. The case for SOEs is weak when markets are competitive and private firms provide goods and services efficiently. Where SOEs play a dominant role, such as public utilities, improving their performance and achieving a sustainable business model are priorities. Governments will also need to find ways to attract private investment to complement the activities of SOEs, which are unlikely to be able to satisfy all development goals.

Governments need to set appropriate incentives and build sound institutions to ensure SOEs operate efficiently and fiscal costs are contained. A strong framework would include a clear and comprehensive ownership policy supported by appropriate government oversight and good corporate governance. Transparency of SOE activities and their relations with the government is critical to bolster accountability.

In view of the growing presence of SOEs in global trade and investment, ensuring a level competitive playing field is important to foster economic efficiency at home and to address international spillovers. Several countries have adopted rules with this aim. Some of these issues are also flagged in international trade and investment treaties. However, there is room for a more coordinated international approach that could benefit from setting global principles for multinational SOEs.

Box 3.1. Experience with Privatization

Privatization, done right, can mean improved firm performance, healthier public finances, and positive macroeconomic effects (Estrin and Pelletier 2018; Estrin and others 2009; Megginson and Netter 2001). The literature suggests that privatized firms outperform SOEs but underperform firms that have always been in private hands (Harrison and others 2019; Shirley and Walsh 2000). So, how can privatization be "done right" and what happens if necessary, conditions are not met?

Privatization has disappointed when complementary institutional and market reforms, as well as equity goals, are not pursued with equal vigor. The existence of a competitive market, the protection of property rights, and the privatization method are important to the outcome of the privatization (Hanousek, Kocenda, and Svejnar 2008; Havrylyshyn and McGettigan 1999). In Russia and Ukraine, for example, rapid mass privatization within a framework of weak governance and regulation often led to bid rigging and limited, if any, efficiency improvements (Rose-Ackerman and Palifka 2016). Estache and Trujillo (2008) find significant productivity gains after pre-2000 privatization in Latin American countries but point to employment loss and unequal distribution of privatization rents, especially for noncompetitive activities. Privatization reversals are also common where regulation is not effective. Power sector privatizations were reversed in the Dominican Republic, the Indian state of Odisha, and some African countries when tariffs remained too low or the utility was not yet functioning at a basic level (Foster and Rana 2020).

Sector dynamics are also relevant for privatization success. Take, for example, water supply, a natural monopoly. There could be a tension between ensuring affordable provision of water and adequate profits by the private firm. In Guinea, private participation in the sector increased access to water by 10 percent from 1986 to 1997 but made the price of water 40 times more expensive (Nellis 2008). Privatization was reversed in 2003.[1] Similarly, in California in the 1990s electricity generation was privatized in a push for higher efficiency and lower prices. Lobbying for deregulation, subsequent fraudulent behavior, and the search for higher company stock values resulted in several problems and a hike in electricity prices (Rose-Ackerman and Palifka 2016; Tillman 2009). Similar arguments against privatization have been raised for other sectors, including electricity transmission and other infrastructure (such as roads and railways).

Popular concerns about the impact of privatization have not always been warranted. Employees and labor unions oppose privatization because of the threat of layoffs (Andrews and Dowling 1998; Boix 1997; Chong, Guillenand, and López-de-Silanes 2011), as in Nicaragua and Argentina in the 1990s. However, privatization can lead to employment gains even if employment and wages in the former state firm fall (Davis and others 2000; Earle and Shpak 2019; Estache and Trujillo 2008). After Zambia Airways was liquidated, two new private airlines emerged, leading to higher employment in the sector (Kikeri 1998). McKenzie and Mookherjee (2003) find that utility prices, on average, fell by 50 percent in some Latin American countries after privatization, and in countries where prices rose, access to previously unavailable goods and services did too.

Realizing the benefits of privatization requires certain preconditions to achieve success: a solid regulatory framework, including a well-functioning legal system, an effective and independent regulator and strong property rights; and relatively low levels of corruption to permit a transparent sale process and prevent embezzlement of SOE assets in the run-up to privatization.[2] Moreover, privatized firms will be more likely to be efficient and to serve the public if there is sufficient competition in the underlying market or an independent regulator at the onset of privatization. Frequent renegotiation of contracts in the public services sector after privatization in Latin America indicates the failure of efforts to achieve competition in markets with too few bidders for the auctioned firms (Estache and Trujillo 2008). Low barriers to new domestic firm entry and openness to foreign direct investment can remedy this problem.

[1]See also Kirkpatrick and others (2006) and Tan (2012) for mixed results of private participation in the water sector.

[2]See, for example, Balza, Jimenez, and Mercado (2013); Estrin and Pelletier (2018); Gasmi and others (2013); Jomo (2008); Kikeri and Kolo (2005); Kikeri and Nellis (2004); Rose-Ackerman and Palifka (2016); and Zhang, Parker, and Kirkpatrick (2008) for discussions on the different preconditions and consequences of their absence.

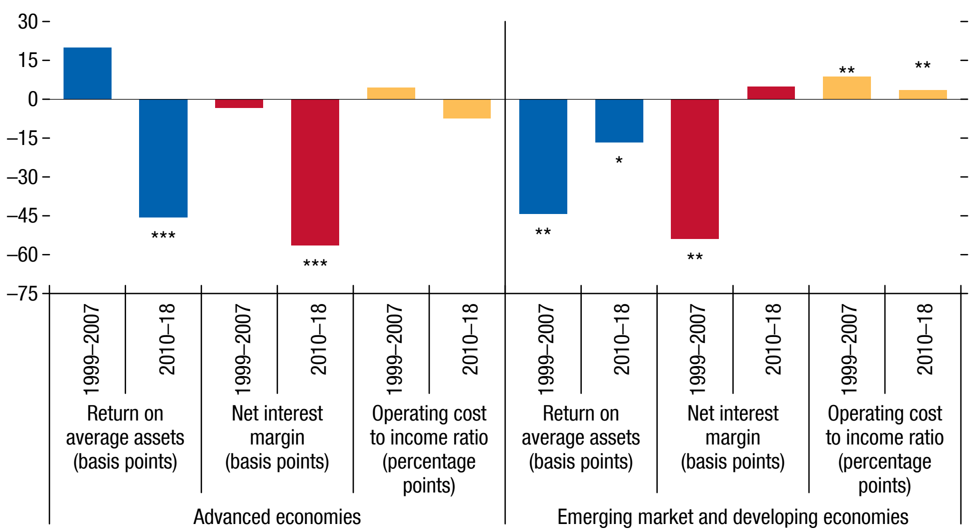
Box 3.2. State-Owned Banks

Public banks comprise two broad categories: commercial banks, which provide competitive banking services, and development banks, which provide credit for development-related projects, usually at subsidized rates, with funding coming from the budget or with government guarantees. In practice, the two types are hard to differentiate given that both have public mandates. One common stated objective is to finance socially valuable but financially unattractive or highly risky projects, such as lending to young, small, and innovative firms (for example, the Business Development Bank of Canada). Another is to finance capital-intensive infrastructure projects (for example, the Development Bank of Southern Africa).

Public banks have struggled to achieve their socioeconomic mandates. Studies have shown that greater state ownership of banks is associated with lower levels of financial development, weaker economic growth, and higher financial instability (Barth, Caprio, and Levine 2004; Beck and others 2008; La Porta, Lopez-de-Silanes, and Shleifer 2002). There is a concern that the state presence politicizes credit allocation (including lending to connected entities or other SOEs). For example, in Ukraine's state-owned banks, politically motivated lending led to massive losses in recent years and repeated recapitalizations by the state (Repko 2019). But public banks can also play a positive role. For example, Mexico's NAFIN is credited for fostering financial development, innovation, and inclusion (de La Torre, Gozzi, and Schmukler 2017).

The empirical evidence on financial performance is mixed. Public commercial banks operating in developing economies tend to have lower profitability and interest margins, higher overhead costs, and higher nonperforming loans than private banks, whereas no significant performance differences are found in advanced economies (for instance, Berger, Hasan, and Zhou 2009; Iannotta, Nocera, and Sironi 2007; Micco, Panizza, and Yanez 2007). A sample of more than 4,000 banks in 125 countries over the past two decades shows that public commercial banks are less profitable and cost-efficient than their private counterparts (see Online Annex 3.3), not even accounting for the substantial guarantees, subsidies, and preferential treatment that public banks enjoy. Comparing the decades before and after the global financial crisis, however, the findings suggest that the performance differences have narrowed between public and private commercial banks in emerging market and developing economies but widened in advanced economies (Figure 3.2.1). For emerging market and developing economies, one hypothesis is that greater government support for public commercial banks after the global financial crisis boosted their profitability. In advanced economies, the ultra-loose monetary policy after the crisis tended to have a disproportionate effect on public commercial banks because they lend more locally than their private peers.

Figure 3.2.1. Financial Performance of Public Relative to Private Commercial Banks



Source: Fitch Connect; and IMF staff estimates.
Note: Regressions control for several factors, including other bank characteristics. ***, **, and * indicate statistical difference from zero at 1, 5, and 10 percent significance level, respectively.

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Integrated State-Owned Enterprises Framework iSOEF

Thematic Guidance Note: Restructuring State-Owned Enterprises

WORLD BANK GROUP

INTEGRATED STATE-OWNED ENTERPRISE FRAMEWORK (iSOEF)

THEMATIC GUIDANCE NOTE

RESTRUCTURING STATE-OWNED ENTERPRISES

July 2021

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
CEO	Chief Executive Officer
DPF	Development Policy Financing
DSO	Days-Sales Outstanding
EBIT	Earnings Before Interest and Tax
EBITDA	Earnings Before Interest and Tax, Depreciation and Amortization
EBRD	European Bank for Reconstruction and Development
GDP	Gross Domestic Product
GMD	Gambian Dalasi
IFRS	International Financial Reporting Standards
IGAPE	Institute for Asset Management and State Holdings (Angola)
ISA	International Standards on Auditing
iSOEF	World Bank Integrated SOE Framework
KPI	Key Performance Indicator
kWh	Kilowatt-hour
MoF	Ministry of Finance
MW	Megawatt
NAOL	National Airport Operator Ltd.
NAWEC	National Water and Electricity Company (Gambia)
PKP	*Polskie Koleje Państwowe* (Polish Railways)
PPP	Public Private Partnership
PSO	Public Service Obligation
SEMRY	*Société d'Expansion et Modernisation de Riziculture de Yagoua*
SOE	State-Owned Enterprise
SWOT	Strengths, Weaknesses, Opportunities and Threats
WB/WBG	World Bank / World Bank Group

CONTENTS

PREFACE

This guidance note on state-owned enterprise (SOE) restructuring is part of the Integrated State-Owned Enterprise Framework (iSOEF), whose overall aim is to provide guidance on assessing the performance of state-owned enterprises (SOEs) in an economy—their rationale, their economic implications, factors enabling their operational efficiency, and options for reforming the sector.

The iSOEF takes a modular approach, allowing for flexible application according to the specific country context and development needs. Modules 1–4 address the role of SOEs in the market, their fiscal and distributional implications, and corporate governance and accountability mechanisms. Module 5 takes a sectoral perspective, focusing on state-owned financial institutions. Finally, four thematic modules (including this one) address cross-cutting factors such as corruption risks, political economy considerations, communication strategies, and restructuring. Each module contains additional analytical tools, matrices, questionnaires, key indicators, and other analytical instruments to be used for diagnostics and assessment.

This guidance note was prepared by Henri Fortin (Lead Financial Management Specialist and Global Lead, SOE Corporate Governance) and Bernard Drum (Consultant), with support from Zana Bacaj (Consultant). Aleksandar Crnomarkovic, Andrea Dall'Olio, Charles Schlumberger, Chris Trimble, Kjetil Hansen and Sergei Shatalov provided inputs during its preparation. The note further benefitted from guidance from Abdoulaye Seck, Manuel Vargas and peer reviewers Andrei Busuioc, Ira Lieberman, Immanuel Steinhilper and Pedro Antman first second round of review), as well as Alexander Pankov, Pedro L. Rodriguez and Sarah Cuttaree (second round of review).

OVERVIEW

In many countries, the SOE sector has been plagued by operational and financial problems and is a source of contingent liabilities for the State. Many SOEs have posted large losses, are heavily indebted and have built up significant trade, tax and other types of arrears. Many have also underperformed in terms of their public service delivery. To put these SOEs on a sustainable pathway, Governments are seeking solutions including (i) encouraging new market entrants by opening up SOE-dominated markets to competition, (ii) full or partial divestiture, (iii) SOE closure, (iv) transfer of non-commercial SOE activities to the central administration, and (v) restructuring SOEs. This thematic guidance note focuses on item (v), i.e., the restructuring of SOEs that will remain in State hands.

SOE restructuring entail two main sets of measures: financial and operational. The restructuring of an SOE follows closely the principles, processes and methods widely applied in the restructuring of private enterprises. Financial restructuring – often referred to as a "balance sheet restructuring" – aims primarily at restoring the SOE to a solvent financial position. Operational restructuring seeks to improve the SOE's productivity and effectiveness. The combination of the two sets of measures, if successfully executed, can lead to significant improvement in financial performance including profitability, and in the quality-of-service delivery.

The methods for restructuring "purely commercial" SOEs and public utilities follow the same fundamental principles, but the way to implement them may differ due to the environment in which the SOEs operate. In the case of an SOE engaged in the "tradeable" products sector, the approach taken is normally opening up the sector to competition, and full or partial privatization. Increasingly, and in particular in the case of restructuring public utilities (e.g., electricity, water supply, and ports), the emphasis is often first on improving the structure of the sector to include market liberalization with strong and independent regulation, then on allowing the private sector to operate in segments of the market where competition is viable (e.g., electricity generation or distribution).

The first step to develop a restructuring plan is to diagnose the problems facing the SOEs. Restructuring is fundamentally about tackling the issues that cause the SOE to underperform. To gain a thorough understanding of these issues is a critical initial step. Like any enterprise or organization, SOEs can face a myriad of problems, external – related to the markets and institutional framework they operate – or internal – involving their strategy, pricing, financial structure, costs, organization, etc. Some of these problems are structural others are related to recent events and other external factors. A "strengths, weaknesses, opportunities and threats" (SWOT) matrix is typically prepared to summarize the key findings from the diagnostic.

Based on the rigorous diagnosis and prevailing government SOE ownership policies, the next step is to assess whether restructuring the SOE in state hands would be the best choice. If restructuring under state ownership is selected an assessment needs to be made of the range of actions the SOE or the authorities would need to undertake**.** These actions could entail policy and regulatory changes (including those affecting tariffs); changes to the legal and institutional framework for restructuring; debt “workout”; internal measures such as the change of business model, workforce reduction, reorganization and corporate governance improvements (e.g., professionalizing the board of directors); and other measures aimed at improving the operational efficiency of the SOE.

If divestiture, rather than restructuring in State hands, is the preferred option, then some preliminary restructuring prior to divestment may still be necessary. However any pre-privatization restructuring should be defensive in nature and strictly limited to necessary measures such as unbundling or reduction of debt or labor costs. Major restructuring decisions in such cases in terms of new investments, new products or services or expansion into new markets should not be taken by the State but be left to the new private investors.

Accompanying measures will need to be considered and included in the restructuring plan to mitigate any adverse social consequences of the restructuring actions, such as workforce optimization. These should be tailored to the situation in the country and combine financial support for retrenched employees in the short term with opportunities, assistance and incentives for finding new employment. The restructuring plan will typically include direct severance payments and other support such as extension of medical benefits for employees.

The restructuring plan needs to be translated into a business plan. This includes financial projections (including revenues, net income, capital expenditure, free cash flow and debt servicing/repayment) and performance targets for the duration of the plan.

A critical success factor in developing a restructuring plan is stakeholder consultation. Engaging with stakeholders can not only help improve the design of the plan but also increase its acceptance and likelihood of success. Mitigation measures to ease the impact of employee retrenchment will need to be discussed with labor unions and other employee representatives.

As for any process involving the implementation of a plan in a changing and challenging context, a strong monitoring and evaluation (M&E) framework is critical. For the best chances of success, SOE restructuring needs should be anticipated through monitoring for early warning signs, and restructuring programs planned and launched before the SOE’s performance has deteriorated to crisis level. Also, while an SOE restructuring plan will benefit from having an initial focus on “quick wins”, then, beyond the short term, it should be reviewed regularly during implementation and updated as circumstances change and experience is gained. SOE restructuring, as with private enterprise restructuring, is a long-term process, sometimes taking up to a decade to complete and often ongoing as a continuous process,

This Thematic Guidance Note includes six case studies covering five sectors (including from Cameroon, Gambia, Poland and Serbia). In five of these cases, the World Bank financed activities leading to the adoption of the restructuring plan. For four of them, significant results have been obtained. For SEMRY Cameroon, the restructuring is still at the early implementation stage.

1. INTRODUCTION

1.1. CONTEXT

In many developing countries, the State is still a major owner of business entities, often known as state-owned enterprises (SOEs). This is particularly true in sectors such as electricity, mining, oil and gas, transport, telecommunications, water and sanitation, financial services, social housing, agriculture, and some commercial entities in manufacturing and trading. Most governments see SOEs as tools to meet social and other objectives (e.g., job creation and global expansion). Many of these SOEs face operational and financial challenges that hinder their performance, translating into poor service delivery, financial losses, increasing indebtedness, liquidity problems, and a growing burden on public finances.

To tackle these challenges and mitigate the fiscal risks associated with SOEs, governments have embarked on a process of reforming their SOEs. A range of measures and modalities has been adopted to achieve the desired performance improvements. Some of these measures include the involvement of private actors through liberalizing markets, public-private partnerships, restructuring of ownership through privatization, and closing down of SOEs while in some cases transferring any essential non-commercial public service activities to the central administration, and restructuring SOEs, while keeping them in state hands, or a combination of these different types of measures. Table 1 below shows paths adopted in SOE reform initiatives.

Table 1: Possible individual SOE reform paths

SOE functions	Reform path
The SOE operates under a monopoly but, competition from the private sector could result in better and more efficient public service delivery	Liberalize the SOE's market by opening it up to competition from new entrants and, if the domestic regulatory environment and market conditions allow it, list the SOE on the local market
The SOE operates in a fully commercial and competitive sector and, there is no public policy reason for continued state ownership	Partially divest or privatize
The SOE no longer fulfills a useful function	Liquidate / close down the SOE
The SOE has an important non-commercial public service function and no longer engages or plans to engage in commercial activities	After closing down or divesting from commercial activities using the options above, transform the SOE into a parastatal entity or transfer its residual (non-commercial) activities to the central administration

The SOE has commercial activities for which government has determined state ownership remains the best option in the foreseeable future	Fully corporatize and restructure the SOE as needed

The focus of this thematic guidance note is limited to the last option above, i.e., to the processes used to restructure those SOEs that will remain in State hands. But in adopting this, the note takes account of lessons learned during recent decades of experience with SOE restructuring and fully acknowledges that, without accompanying safeguards, SOEs can distort markets, stifle competition and growth, and impose a heavy burden on public finances. The recommendations for SOE restructuring processes, and particularly for accompanying measures, include actions to minimize these risks.

For many years, the design and implementation of restructuring plans has been a significant component of SOE reform programs in countries supported by the World Bank Group (WBG). Similarly, regional international financial institutions such as the African Development Bank (AfDB), Asian Development Bank, and European Bank for Reconstruction and Development (EBRD) have provided support to developing countries in preparing SOE turnaround strategies or restructuring plans.[1]

The purpose of this note is to provide Bank teams and partner-country Governments with an approach to restructuring SOEs based on international experience, mainly in developing countries.[2] This proposed approach covers key dimensions of SOE restructuring. It draws on and provides appropriate references to existing material in the field of enterprise restructuring. It aims to be practical, with concrete case studies, and to be adaptable in low income and developing-countries with weak institutional capacities.

1.2. WHAT IS SOE RESTRUCTURING?

Although SOE restructuring can have many meanings in various contexts and under different country circumstances, fundamentally it consists of a comprehensive set of actions taken by the management/shareholders that aims to rebuild the SOE's operational and economic viability. Restructuring an SOE usually becomes necessary when the enterprise is having serious

[1] For examples of such initiatives, see AfDB (2019, 35), available at: https://www.afdb.org/sites/default/files/2019/07/09/zimbabwe_infrastructure_report_2019_-_afdb_-_20052019.pdf, and EBRD (2020), available at: https://www.ebrd.com/cs/Satellite?c=Content&cid=1395271842258&d=Mobile&pagename=EBRD%2FContent%2FContentLayout.

[2] The principles in this note are applicable to SOEs across all sectors, although restructuring of financial institutions requires specific treatment that is covered elsewhere in World Bank (2019a).

financial challenges or shortcomings in the quality and quantity of its products or service delivery. In most cases it is a critical part of a broader economic reform program aiming to improve the SOE's governance and effectiveness in essential service delivery while reducing the budgetary burden and fiscal risks posed by the SOE. Restructuring typically entails modifications across two main dimensions:

i. ***Financial:*** **Focuses on restoring the SOE's solvency and liquidity.** This is often motivated by the need to reduce the SOE's explicit and implicit burden on public finances, including reducing its associated fiscal risks. Such restructuring often combines operational restructuring with financial measures such as debt workouts, arrears clearance, assets disposals, and capital injections. This exercise usually requires a precise stocktaking of existing liabilities by creditor category, type of instrument, and maturity profiles.

ii. ***Operational:*** **Aims to restore the SOE's future performance and viability.** This can be done, for example, by redefining the SOE's business model, product mix, and organization; by splitting, combining, relocating, or divesting parts of its operations; by increasing the capital intensity and product quality by acquiring new technology, equipment, or other assets and changing the skills mix in the workforce; and by cutting costs across all aspects of operations. In many cases, SOE restructuring also includes reducing the size of the workforce.

Successful SOE restructuring typically entails a sequence of three steps. The first step is to diagnose the problems facing the SOE. The second step is to formulate restructuring options and develop the plan, if the diagnosis concludes that the SOE could be viable and should remain in state hands. The third step is to finalize and implement the plan while monitoring and evaluating progress and adjusting as necessary, in consultation with stakeholders. The following sections review each of these steps in turn.

While the methods for restructuring purely commercial SOEs have much in common with those for restructuring public utilities in terms of financial restructuring and efficiency improvements, there can be considerable differences in approaches particularly, related to changes to the SOE's operating environment. For SOEs engaged in tradeable products, the approach taken is usually opening up the sector to trade competition and, concomitantly, fully or partially privatizing the SOEs concerned. For public utilities operating as monopolies and managing major infrastructure in sectors such as electricity, water supply, transport, the emphasis is often first on improving the structure of the sector, with strong and independent regulation, then allowing the private sector to operate in areas of the sector where competition is viable, for example, electricity distribution in the power sector.

2. DIAGNOSING THE PROBLEMS FACING SOES

The essential first step before launching an SOE restructuring program is to complete a rigorous diagnosis of the situation and problems facing the enterprise. This could, for example, take the form of a "Strengths, Weaknesses, Opportunities, and Threats" (SWOT) analysis of the enterprise. Whichever form it takes, the diagnosis needs to review: (i) the sector context, government policies, and the market in which the SOE operates; (ii) the legal and institutional framework that governs SOE restructuring in the country; (iii) the SOE's established objectives and role, and their appropriateness within the sector context; (iv) the SOE's financial performance; and (v) the SOE's operational performance and organizational effectiveness. Diagnostic analyses and reports of this type are typically carried out by consulting firms or outside advisors.

2.1. COUNTRY, SECTOR AND MARKET CONTEXT

The ultimate success of any SOE restructuring process will depend not only on factors internal to the enterprise but, to a large extent, on the country, sectoral and policy environment in which the SOE operates. Conditions in the market for the SOE's products—together with prevailing policies governing the macroeconomic environment, competition, trade, pricing, taxation, labor, sectoral regulation, budget support, and SOE ownership policy—can all have a major impact on the SOE's performance and on the likelihood that the restructuring process will succeed or fail (Lieberman et al 1989). Policies and needs concerning climate change, adaptation and environmental impact are also important, particularly for those SOEs which are in the energy sector or large energy consumers. The diagnosis of problems facing SOEs, therefore, needs to review all of these factors and determine which of them have an impact on the SOE's financial viability and operational performance, and on the costs that government may have to bear to keep the SOE in operation, even after restructuring.

A critical question to be addressed is whether: (a) the SOE has a monopoly or a protected role in its sector, or (b) there is open competition among market participants. Is the SOE a public utility or natural monopoly with only limited competition or is it a fully commercial SOE producing and/or selling tradeable goods or services in an open market? Does the SOE operate on a level playing field with private competitors, or does it pay lower taxes, customs duties, and dividend rates compared to private companies? Does it benefit from preferential access to government contracts? If there is competition, how does it affect the SOE's operations and financial performance? Is the SOE competitive? Is it subject to the same competition law requirements as private companies? In many countries—and in some competitive sectors such as telecommunications and industrial production or commercial services—policies to encourage competition for SOEs from new private entrants or to privatize SOEs have sometimes proven to be more successful in improving service quality and reducing the burden on public finances than trying to restructure the entity in state hands. In such cases, closing down the SOE, selling its assets, and allowing new private market entrants can be a viable alternative to trying to restructure or even privatize the SOE. Even in monopoly or semi-monopoly situations, for example in sectors such as electricity generation or distribution and airline transport, privatization or public-private partnerships can be alternatives to state control over the entity managing these activities—provided that effective regulatory and institutional frameworks are in place.

External reasons for SOE non-viability often include a policy of non-reimbursement or only partial reimbursement by the government of the public service obligations (PSOs) that it imposes on the SOE. PSOs can include either: (i) provision of services for social rather than commercial reasons, such as universal service obligations in unprofitable areas; or (ii) more general tariff policies that do not allow the SOE to recover its full operating and financing costs. A related problem is the failure of the state to enforce full payment of utility bills by government entities. Assessing the costs of PSOs can often require changes in the SOE's cost accounting systems, which in many cases do not adequately apportion the costs of PSOs and those of fully commercial activities. Such problems are illustrated in the case of NAWEC, the power and water utility of The Gambia (Annex 1).

The diagnostic review needs to assess to what extent the SOE can be well-managed and competitive under the existing policy environment and, if not, to what extent the policy environment can or should be changed. It needs to assess the implications of such changes for the SOE's financial performance and for public finances. Assessments of SOE financial viability need to account for international market prices to understand whether the SOE is internationally competitive or whether the state would need to protect its SOE to keep it in business. If the latter, the diagnosis will need to determine whether the government would be justified in allowing the SOE to pass on its higher costs to consumers when lower-cost solutions are available from competitors.

Political economy factors need to be carefully considered as well. Part of the reason why improving the governance and performance of SOEs is challenging is that a multitude of political economy factors come into play in the process at the moment of deciding which measures to undertake. These factors originate within the SOE itself, and in the interface between SOEs, on the one hand, and the ecosystem within which they operate including government, on the other. As further discussed in Section 4.1, a critical aspect of successful restructuring is stakeholder engagement at the design and implementation stages. To that end, mapping the SOE landscape and stakeholders (including owners, managers, workers, labor unions and other influencers) is an essential aspect of the work preparatory to the design of the restructuring plan.

2.2. LEGAL AND INSTITUTIONAL FRAMEWORK

In addition to the external factors described above (Section 2.1), SOE restructuring processes will be affected by the broader legal and institutional considerations that govern SOEs and SOE restructuring in the country. Many countries that have experienced systemic financial distress—for example, some East Asian countries during the financial crisis of the late 1990s—have adopted formal corporate restructuring frameworks intended to facilitate needed restructuring of enterprises, particularly debt resolution. Other countries have specific SOE laws that may include provisions for restructuring. In the absence of such frameworks, however, SOE restructuring is normally subject to existing laws governing general enterprise restructuring, insolvency, and debt resolution. In some countries, these laws may be outdated and can thus impede efficient restructuring.

In an environment where SOE restructuring, or even general private enterprise restructuring, is becoming necessary, governments will likely need to review the legal framework and identify any impediments. Laws and institutions that can have a major impact on the restructuring process are those affecting property rights, including land; collateral, including registries; courts that oversee insolvency, debt resolution and enforcement; and taxation that affects debt reductions or other financial actions that can form part of SOE restructuring. Also, in some countries, particularly formerly centrally planned economies, SOEs may not have a corporate form that would enable key restructuring actions such as debt/equity conversions, share sales or applying the same corporate governance requirements as private companies. In these cases, the "corporatization" of the SOE is often a necessary early step.

SOE ownership arrangements are normally defined in the established SOE legal and institutional framework, but some governments have established SOE ownership policies. (World Bank 2014). Because SOE laws and ownership policies can often affect the types of SOE restructuring that are permitted or favored, they need to be assessed and taken into account as part of the planning of a restructuring program. Typically, the ownership policy will define the following: (i) the purpose of state ownership; (ii) the types of enterprises that will be owned by the State and are covered by the policy (commercial, non-commercial, or both); (iii) the criteria under which SOEs are required to operate (commercial versus non-commercial); (iv) the roles and responsibilities of specific oversight and regulatory institutions; (v) the requirements for transparency and disclosure in reporting; (vi) the separation of roles among the state, boards of directors, and SOE management; (vii) the degree of operational autonomy the SOE has; (viii) the fiduciary duties of boards and SOE management; and (ix) guidance on how to handle conflicts between commercial and non-commercial objectives.

Decentralized SOE ownership structures, where SOEs report to line ministries, are steadily being replaced around the world by more centralized and specialized structures, which can play a key role in the restructuring of SOEs. The main objectives of this centralization, which is the recommended practice in the OECD's Guidelines on Corporate Governance of SOEs, are to (i) separate ownership functions from policy-making and regulatory functions; (ii) minimize the scope for political interference; and (iii) promote greater coherence and consistency in exercising the state's ownership role across all SOEs. Such entities may be government ministries or departments (e.g., the Ministry of State Enterprises of Indonesia, the Office of Public Sector Governance of Mauritius, the Department of Public Enterprises in South Africa), government agencies (e.g., China's State-Owned Assets Supervision and Administration Commission and France's *Agence des Participations de l'Etat*), or holding or investment companies (e.g., Malaysia's *Khazanah Nasional* and Singapore's *Temasek Holdings*). Such agencies or companies often report to the Ministry of Finance. The centralized ownership function may also be exercised directly by the Ministry of Finance, as is the case in the Netherlands and New Zealand.

In the centralized model, the ownership entity typically plays a central oversight role, consolidating roles formerly played by line ministries. It (i) monitors, analyses, and reports SOE performance and prospects for the future, helping to develop annual plans and KPIs, (ii) guides and oversees reforms, including the restructuring of SOEs, and optimizes the use of available restructuring capacity by prioritizing those SOEs in greatest need of action (iii) manages the appointment of Board members and drafts rules and regulations on corporate governance of SOEs, and (iv) decides or advises the government on equity investments, mergers, sales of assets, and other forms of privatization of SOEs. In countries with a centralized model the central SOE ownership entity will typically take the lead role in SOE restructuring.

An assessment of banking system capacity is also likely to be needed since the financial restructuring of SOEs often requires debt reductions, including write-offs and increased provisioning for restructured loans. A full assessment of the debt profile of the SOEs is first required to determine the banking system's exposure to SOE loans. This will produce a breakdown of SOE debt, for example into long v. short term, foreign exchange v. local currency, bonds v. loans v. advances from the State. Also, many countries faced with the need to restructure their SOEs have banks with high levels of non-performing loans, which, in addition, are often under provisioned, resulting in high vulnerability. In such cases, SOE restructuring will likely require increased capital in the banks. Given these factors, combined with the possibility that the tax regime may treat forgiven debts as taxable income, these banks may be unwilling or unable to participate in debt restructuring. Moreover, in some countries, there are many state-owned banks and issues of cross-ownership between those banks and the SOEs, which can expose banks or borrowers to possible liability to other stakeholders in a restructuring context (Johnson, 2019).

2.3. APPROPRIATENESS OF SOE OBJECTIVES AND ROLES

An assessment should be made as to whether the SOE's objectives, roles, and activities are appropriate to the environment in which it operates. Many SOEs were created to serve purposes that are no longer relevant. For example, some SOEs that provide goods or services were created originally to serve markets where there was no national private provider. Is the SOE's role still appropriate after new national private providers have entered the market? In other cases, an SOE may have been created as a means of assuring price competition in markets that were deemed to be monopolistic or oligopolistic. However, liberalization of markets and application of effective regulation and competition laws and institutions may provide more benefits to consumers than trying to restructure an increasingly non-viable SOE. In some cases, it may be appropriate to keep the SOE in operation but to downsize it and reduce the scope of its activities

The issue of whether and how to restructure SOEs has become particularly acute in the context of COVID-19 in sectors, such as air transportation, that have borne the brunt of the pandemic's negative economic impacts. Although it is too early to draw definitive conclusions, some governments have decided not to support financially distressed airlines and have rolled back significantly strategies that promote a national carrier. South African Airways is an example.

2.4. FINANCIAL PERFORMANCE ASSESSMENT

Mounting losses, expanding debts and arrears, growing insolvency, and an increasing demand for government financial support are indicators that often suggest a need for SOE restructuring. The case studies from Cameroon, Gambia, Poland and Serbia (plus an undisclosed country) shown in Annexes 1-5 illustrate these problems. An important diagnostic step in this regard is a comprehensive review of the enterprise's financial performance. This review should draw on the SOE's audited financial statements and management reports, other internal SOE financial reports, performance monitoring reports from SOE oversight agencies, and reports from the finance ministry and the tax and customs authorities on the history of the SOE's financial relations with the government. It is important that this assessment gather information for at least five years in order to have sufficient data to evaluate performance trends over time. Also, to assess the SOE's performance in context the SOE's financial performance should be benchmarked against indicators for SOEs in other countries where such comparative information is available and also, where the SOE is in a competitive sector, for private enterprises in the country. Finally, the financial performance needs to be compared with the targets previously agreed between the SOE and the ownership and oversight entities.

The assessment of SOE financial performance needs to analyze a range of indicators from the SOE's income statements, balance sheets, and cash flow statements. First, the quality and timeliness of the accounts need to be assessed—that is, whether they are up to date, prepared according to International Financial Reporting Standards (IFRS), and audited by reputable firms according to International Standards on Auditing (ISA). Next, many indicators can be derived from the SOE's financial statements. Indicators frequently used to assess financial viability include earnings before interest, tax, depreciation and amortization (EBITDA), earnings before interest and tax (EBIT), net profit margin, return on equity and return on capital employed. Other financial performance ratios used include the vulnerability of stocks (stocks/working capital) and days sales outstanding (DSO, or trade debtors/average daily sales). Finally, financial soundness indicators include the debt-to-equity ratio, the current ratio (current assets/current liabilities), and the liquidity ratio (liquid assets/current liabilities).[3]

The government will also need to assess the impact, direct and indirect, of the SOE on public finances. Direct transfers from the Government to SOEs include operating and capital subsidies and disbursement of loans to SOEs. Direct revenues received from SOEs include payments of dividends, taxes, import duties and royalties, and loan repayments. Indirect revenues from SOEs include non-payment by the Government of public service obligations and in many cases non-payment or arrears in payment for services received from the SOE. But SOEs are often granted full or partial tax, duty and royalty concessions, are not required to pay dividends, or are in arrears or in default in making these payments. These concessions, arrears and defaults are indirect subsidies from Government to the SOEs.

Moreover, SOE loans from sovereign and commercial lenders are frequently guaranteed by the government, representing an explicit contingent liability on the government. When SOEs in distress default on these loans, the guarantees are called, and they become a direct liability for the government. Even in cases where loans are not guaranteed or where SOEs default in their payment of trade debts to suppliers, or are required to make large unforeseen financial outlays, particularly SOEs that are providing essential services (see for example the case of NAWEC in the Gambia in Annex 1), the Government is often called on to provide the necessary funding. All subsidies, both direct and indirect, along with contingent liabilities, explicit and implicit, need to be taken into account by the government in assessing the fiscal risk they are sustaining from SOEs.

An analysis of absolute and relative (that is, as a percentage of gross domestic product, or GDP) impacts can be complemented by ratios indicating the SOE's dependence on government

[3] There is a large body of literature on financial analysis. One overview of financial analysis techniques can be found at: https://www.cfainstitute.org/-/media/documents/support/programs/cfa/2019-L1V3R26-footnotes.pdf (accessed June 1, 2020).

financing. One such ratio is that of subsidies to total revenue. Other relevant indicators include the cost of the SOE's public service obligations paid by the government and the extent to which these payments fully cover the actual costs incurred by the SOEs. The portion of PSO costs that exceed the remuneration received by the SOE from the state represents a "quasi-fiscal activity," which, in essence, implies hidden budgetary costs and distorts the presentation of the SOE's performance.

2.5. OPERATIONAL PERFORMANCE AND ORGANIZATIONAL EFFECTIVENESS ASSESSMENT

An analysis of the SOE's operational performance and organizational effectiveness is of critical importance in determining whether and how restructuring may be appropriate. The SOE's financial statements can give some indication of its operational performance—for example, cost breakdown ratios, which show contributions to total costs, of maintenance, payroll, and administrative costs; capital intensity (total assets/revenue and capital expenditure/labor costs); value-added per employee; turnover of stocks (sales/stocks); and revenue per customer. In addition, a host of non-financial performance indicators can be used to explain problems that may already have been identified in the financial performance assessment and to identify underlying structural, organizational, and operational performance problems. As with financial performance assessment, the SOE's operational performance should be benchmarked where possible against that of similar SOEs in other countries and any private sector competitors; it also needs to be compared with previously agreed targets.

The operational and organizational assessment should cover all key issues involving the management and operation of the enterprise. These issues include internal aspects of corporate governance; organization structure; the quality of general management; the quality of management of finance and accounts, production, marketing and distribution, research and development, and human resources; and the extent to which the existing capital investment, technology, and human resources meet the needs of the enterprise. Factors to be taken into account also include the processes for setting and agreeing on performance targets, the extent to which agreed targets have been met, capacity utilization, quality of customer service as measured by customer satisfaction surveys, extent and timeliness of service delivery, employee satisfaction, turnover and training, and bill collection timelines.

Box - Assessing SOE Corporate Governance

Many key aspects of an SOE's corporate governance will be determined not within the enterprise itself but by the legal and institutional environment in which the enterprise operates. Good laws set clear relationships between the government and SOE boards and management. They describe the various SOE legal forms and define and ensure effective oversight of SOEs and SOE accountability. To be effective, SOE ownership entities need to monitor, evaluate and report adequately on SOE performance while at the same time engaging in strategic decision making and holding SOEs accountable for their performance. Ownership entities need to implement effective performance management systems using performance agreements and monitor SOE performance against key financial and non-financial performance indicators (KPIs).

The ownership entity needs to establish and implement a well-structured, merit-based and transparent board nomination process. This should result in a balanced composition of the board of directors, including the necessary competencies through a mix of insiders and independent directors. The board needs to be given the autonomy to make strategic decisions while at the same time being held fully accountable for ethical behavior and results. Board membership should be rotated, and board committees should be set up for important oversight functions such as audit.

Good corporate governance requires adequate and timely financial reporting. The external reporting requirements should be set out in the legal framework and enforced by the supervisory agencies. But good financial reporting will depend also to a large extent on the adequacy of the internal accounting systems and capabilities within the SOEs and within the independent entities responsible for auditing their accounts. The SOE needs to have an effective management information system (MIS). Key performance information should be disclosed publicly and provided to all key stakeholders, and the use of government subsidies should be fully documented and disclosed. Particular attention needs to be given to assessing SOE procurement practices, which may or may not be required to follow government procurement rules.

[For a fuller discussion on the assessment of corporate governance of SOEs see the World Bank's Toolkit on SOE Corporate Governance (2014), the Integrated SOE Framework Module 4 Annex 2 (2019) and the IFC's Corporate Governance Progression Matrix (2019)].

Sector-specific operational performance indicators need to be reviewed as well. An operational assessment of an electricity utility, for example, requires indicators of generation capacity/demand, energy efficiency, system losses (percent of supply), number of outages or transformer failures per year, and illegal connection rates. Similarly, an operational assessment of a water and sanitation utility would require indicators of storage capacity, levels of non-revenue water, water quality, length of the distribution network, interruptions in water supply and time to restore supply, and bacterial content in treated wastewater. For transport SOEs, such as airlines and railways, the assessment would need to include passenger and freight load factors, passenger miles, on-time departures, cancellations, delays, misconnections, and so on. For telecom companies, sector-specific indicators might include call success and drop rates, traffic congestion, user turnover, and price indicators.

Together, the results of all of the analyses discussed in Sections 2.1–2.5 will form the basis of a diagnostic report. This report should layout the problems that the restructuring plan will address, including the SOE's key features (business lines, legal and governance framework and main relations with the State); a strengths, weaknesses, opportunities and threats (SWOT) analysis; the SOE's business plan before restructuring and the key issues to be tackled. This diagnostic report is often prepared by a consulting/professional services firm.

3. FORMULATING OPTIONS AND DEVELOPING THE RESTRUCTURING PLAN

Based on the rigorous diagnosis outlined above, the next step is to assess whether—given the problems it faces—the SOE can be made viable through restructuring in State hands. The fiscal costs of maintaining the status quo versus the costs of restructuring need to be compared. Moreover, the upfront costs normally required in SOE restructuring, such as new capital investment, labor retrenchment, and social mitigation measures, need to be balanced against the long-term potential fiscal gains. Alternative measures to restructuring in state hands, or complementary ones, such as liquidation and closure, privatization, public-private partnerships, and management contracts, should also be considered.

Criteria for deciding between alternatives can vary widely from country to country. In countries where the State has an explicit or implicit SOE ownership policy, the criteria for deciding on divestment or retention of SOEs in State hands will normally be included as part of this policy. Many countries have adopted as a policy to partially divest or privatize SOEs that operate in competitive sector, maintaining controlling stakes when they have determined it is in the public interest. Such cases have included natural monopolies, essential infrastructure operators, SOEs playing a strategic role in the economy, and cases where the market is judged to be unable to provide necessary public goods or services (often referred to "market failures").

If restructuring in State hands is considered the best solution, the diagnosis should point to the areas that need to be addressed through the restructuring process and the types of actions it would entail. Actions may include tariff increases, headcount reduction, adjustments in the organizational structure, debt restructuring, and so on. The restructuring plan will need to be presented in the form of a full business plan, including financial and operational projections and performance targets for the duration of the plan.

3.1. POLICY AND REGULATORY CHANGES

Tariff policies may need to be adjusted to provide for market-based pricing and adequate cost recovery. This applies in particular to public monopolies such as those that often exist in power supply, water supply, and wastewater treatment sectors. Tariffs should be set and adjusted through an independent sector regulator. Important reforms often include increasing the flexibility to adjust tariffs to rapidly changing costs, for example with regard to the cost of fuel needed for power generation. Where an independent regulator does not yet exist, there will be a need to create one.

Related policy changes will include the need to ensure adequate costing of any public-service obligations (PSOs) imposed on the SOE and adequate compensation to the SOE based on those costs. Specifically, the costs of these PSOs will need to be included as line items, or specific programs, in the national budget. Care needs to be taken, however, to ensure that any tariff adjustments and cost reimbursements do not automatically pass SOE operational inefficiencies on to consumers. Price increase formulas—such as the consumer price index minus a percentage factor, to allow for and encourage cost efficiency improvements—can build in incentives for SOEs to maintain and improve their operational efficiency. Similarly, the benefits of reductions in input cost prices need to be passed on to consumers through the tariff-setting formulas.

3.2. CHANGES TO THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR RESTRUCTURING

In the interest of competitive neutrality, SOEs operating in competitive sectors need to be given equal treatment as compared with private companies. They should be subjected to hard budget constraints by Government and not receive preferential tax, customs, or royalty concessions, nor benefit from preferential access to finance, land, buildings, or inputs or preferential access to markets through, for example, government procurement or pricing policies. Any barriers to entry for enterprises in the sector need to be eliminated, along with barriers to exit. Competition laws should be applied equally to SOEs and private competitors. SOEs should not receive any subsidies from the government, other than for the reimbursement of PSOs. Any government investments in the SOE or government guarantees on the SOE's loans should require prior justification based on a commercial rate of return. Commercial dividend policies should be applied to SOEs. Finally, SOEs should be subjected to the same corporate governance requirements and reporting requirements for financial and operating performance as private enterprises, preferably through commercial law or, if not, then through specialist SOE laws.

The diagnostic phase described in Section 2 above will have identified any legal, regulatory, and institutional impediments that may affect the success of the SOE restructuring process. To address these issues, the government may need to revise laws and regulations to simplify, streamline, and speed up the restructuring process. These revisions may include changes to laws and institutions governing property rights, land, collateral (including registries), insolvency courts, debt resolution and enforcement, and tax treatment of debt reductions or other necessary financial adjustments. They could also include strengthening institutions such as collateral registries, creating specialized commercial courts where there are none, strengthening the commercial courts that do exist and promoting the use of out-of-court alternative dispute resolution mechanisms. Design of the financial restructuring components of any SOE restructuring program will also need to take into account limitations in banking system capacity. In some cases, accompanying measures to strengthen the banks may be necessary.

Policymakers are increasingly emphasizing the need to create, within SOE oversight agencies, monitoring systems that identify and focus attention on SOEs in financial distress. The European Union's recent Directive 2019/1023 requires member states to develop early warning tools to notify enterprises in financial difficulty of the need to take prompt action (EBRD 2020). The objective should be to create institutional mechanisms to identify problems, particularly concerning SOE liabilities and liquidity, and to focus early attention on taking remedial measures. Early action, taken before the SOE's situation reaches crisis proportions, will improve the chances of success of the restructuring and other remedial measures.

3.3. FINANCIAL RESTRUCTURING

Many SOEs faced with restructuring are heavily indebted. These debts will often need to be restructured if the enterprise is to regain financial viability and autonomy, including the capacity to borrow from commercial banks or to issue bonds. In some cases, these debts may have resulted in part from the conversion of foreign-denominated debts to local currency. In many cases, SOE debts may have been incurred over several years to finance accumulated losses, in which case it is likely that they are not represented by any assets on the balance sheet. Transfer of some of these debts to the government is often the first step.

Pressure from the SOE's creditors, particularly in the case of guaranteed loans, can be a factor leading Governments to restructure the SOE. The costs of such financial restructuring are often borne entirely by Government but Government may receive assistance from financial institutions to help finance the costs. In some cases debt write-offs may be financed by bonds issued by the SOE itself, as in the case of The Gambia's National Water and Electricity Company (NAWEC) – see Annex 1. However, even in this case, Government later had to assume the full costs of servicing the bond when NAWEC defaulted on its payments to bondholders.

Depending on the projected financial capacity of the restructured SOE, however, some of these debts may be amenable to restructuring through negotiations with creditors. Options for restructuring the SOE's debt may include (i) negotiating a reduction in the principal amount with creditors (i.e., partial write-offs or "haircuts" or "bail-in"); (ii) interest rate reductions, as was done in Uruguay in 2003; (iii) loan tenor[4] extensions (or "reprofiling" of maturities); (iv) other forms of debt exchange (as was the case in Jamaica in 2010), which included the exchange of variable-rate debt for fixed-rate debt; (v) sale of assets, particularly non-productive assets or in cases where downsizing or elimination of non-core activities will be part of the proposed restructuring process, and (vi) debt to equity conversions, particularly in SOEs with high debt/equity ratios and good chances of successful restructuring (as in the case of Serbia's Srbijagas described in Annex 2). Injection of new equity in this way can be an important contributor to the SOE's future viability, not only because it puts the SOE on a more financially stable footing but also because it can bring in commercial know-how, better accountability, and access to additional financing.

3.4. OPERATIONAL AND ORGANIZATIONAL RESTRUCTURING

Internal SOE operational restructuring can take many forms and include a wide range of components. The forms may include a redefinition of the business model, the unbundling of large conglomerates, break-ups, partial divestiture or mergers of discrete operations, changes to the organization structure, general across-the-board cost reductions, improvements in operational efficiency and environmental impact. Labor retrenchment is often an essential part of the restructuring process. A good diagnostic report should give clear indications as to which operational and organizational solutions are most likely to be successful in the given country and market context. The case of SEMRY from Cameroon (Annex 3) is an example of planned major restructuring including many of these components.

While approaches for restructuring purely commercial SOEs have much in common with those for restructuring public utilities in terms of financial restructuring and efficiency improvements, there can however be significant differences. In the case of commercial companies engaged in, for example, steel, oil, gas, petrochemicals or cement, the approach taken is normally opening up the sector to trade competition or fully or partially privatizing the SOEs concerned. In the case of public monopolies and major infrastructures such as electricity, water supply, roads, and ports the approach is primarily concerned with organizing the structure of the sector, ensuring strong and appropriate regulation, while allowing the private sector to operate in areas where competition is viable, for example, electricity distribution.

A change of business model could involve changing the product mix or the targeted market segments in terms of customers, geographical locations, or even export markets. Examples of

[4] Refers to the length of time until the loan is due.

such changes are shown in the case of Srbijagas presented in Annex 2**.** It could also include the adoption of new technologies. Unbundling is often applied to vertically and horizontally integrated SOEs such as those involved in electricity generation, transmission, and distribution. Divestiture of non-core activities such as vehicle fleets, maintenance, office management, catering, and security—is frequently a component of SOE restructuring as in the case of SEMRY in Cameroon, described in Annex 3. Many SOEs in formerly centrally planned economies operated social assets such as health clinics, kindergartens, transport and utilities; divestiture of these assets or transfer of these activities can be an important step in an SOE restructuring. Even in cases where an SOE is not physically or legally split up, the creation of separate cost and profit centers can be an effective restructuring component.

A key component of many restructuring processes is improving the SOE's corporate governance, including strengthening autonomy and accountability and professionalizing the composition and operations of the board of directors (World Bank 2014 and Box above). Other restructuring measures include improving internal and external information flows and accountability; streamlining organization structures; recruiting and training better-qualified managers and technical personnel; improving planning processes; strengthening internal financial management, controls, and audit; and adopting performance incentives for managers and other personnel. SOE restructuring often entails a reduction in surplus labor, which in turn requires measures to mitigate the social impact of the retrenchment. A well-prepared diagnostic report will have included an assessment of the SOE's existing human resources. See Section 3.5 below for more details on the subject of social impact mitigation.

This note focuses only on processes for restructuring SOEs under state ownership and management, even though other approaches exist—especially private participation in ownership and management. These alternative approaches include outright privatization, employee buy-outs and partial share sales, joint ventures, public-private partnerships, leasing of assets, and management contracts, all of which are important SOE restructuring modalities which can improve SOE financial and operational performance and reduce the burden of SOEs on public finances. In some cases, partial SOE restructuring by the state, particularly through "defensive" measures such as unbundling, debt resolution, and shedding of excess labor, is a necessary first step to be carried out by the State before proceeding to divestiture or other forms of private participation. However, if majority private ownership is planned, "positive" restructuring such as a change in product mix, conversion to new technologies and expansion into new markets is best carried out by the new owners.

3.5. SOCIAL IMPACT MITIGATION

Historically, many SOEs have employed a significantly larger workforce than that required for efficient operations. This has resulted in low labor productivity and excessive wage costs, which have in turn exerted a negative impact on SOE operations and financial performance. In addition, restructuring to improve efficiency often includes investments in automated processes, with a consequent increase in capital intensity and shedding of labor. For these reasons, the restructuring of SOEs, more often than not, involves a significant reduction in the size of the workforce. The labor retrenchment resulting from these processes can have substantial social and political implications. As a result, restructuring plans need to include measures to mitigate the social impact of these changes. The case of SEMRY in Cameroon, described in Annex 3 is a good example of the need for such measures.

Mitigation measures should be tailored to the situation in the country and in the SOE concerned and will often need to be multifaceted.[5] The programs will need to be targeted carefully and their impact monitored closely. The objectives will be to include elements of compensation and financial support in the short term—and sometimes over the longer term—for employees who will lose their jobs, while at the same time offering them incentives to leave, along with opportunities and assistance in finding new employment. Labor unions will need to be closely consulted in that respect.

Programs typically include direct severance payments. They may also include extensions of medical and other benefits, retraining for new work opportunities, and counseling and other assistance in searching for and obtaining new jobs. For major labor restructuring programs, governments may start new job creation schemes—in infrastructure development, for example—and may offer employment subsidies to new employers. Support for new business startups through business incubators and other means, along with entrepreneurship training, can also be important components of social mitigation measures and may contribute more broadly to the promotion of economic growth in the region or country where the SOE is located.

4. FINALIZING AND IMPLEMENTING THE RESTRUCTURING PLAN

4.1. REVIEWING OPTIONS WITH STAKEHOLDERS

The restructuring planning process should have resulted in the formulation of restructuring options for consideration by stakeholders and decision-makers. Alternatives need to be developed and considered where possible since there is often more than one way to solve a restructuring challenge, each with its pros and cons. In drawing up and evaluating restructuring

[5] World Bank/PPIAF 2004; Fretwell 2004.

options, it is useful to consider the results of past experiences with restructuring similar SOEs, both in the country concerned and elsewhere.

Several factors need to be taken into account in determining which option is the most suitable. These include the changes in operational performance and quality of output that can be expected to result from the proposed changes, the financial costs and benefits, the level of risk, the impact on the environment and appropriate mitigation measures, potential difficulties and disruptions that may be faced, the possibility of employee resistance to change, the optimal timing for launching the process, and the speed of implementation. The evaluation process should adopt a clear set of criteria against which the various restructuring options can be scored using a transparent process of decision analysis. As mentioned earlier, the restructuring plan should be prepared in the form of a full business plan with financial and operational projections.

Stakeholder consultations are an essential feature of a successful SOE restructuring process. All key players need to be consulted to evaluate the identified options and arrive, to the extent possible, at a consensus on the restructuring plan to be adopted. Labor unions in particular have to be consulted and involved, particularly when employee retrenchment is a component of the restructuring plan. The consultation process often leads to improvements in the design of the restructuring options under consideration and of the chosen option. The extent to which this consultation process results in stakeholder buy-in can be a critical factor in determining the success of implementation.

Another critical lesson learned is that, as with other major reforms, successful SOE restructuring requires strong and enduring political commitment to the process and its intended result. One option for promoting political acceptance and support is the preparation by the government and tabling to the parliament of a white paper outlining the proposed reforms, why they are necessary, and the expected benefits for the country. Another mechanism, widely used during the market reforms in Central and Eastern Europe and the former Soviet Union, is the employment of an external communications firm to develop and implement a public information program aimed at promoting public understanding and support (World Bank 2019b).

4.2. PRESENTING THE RESTRUCTURING PLAN

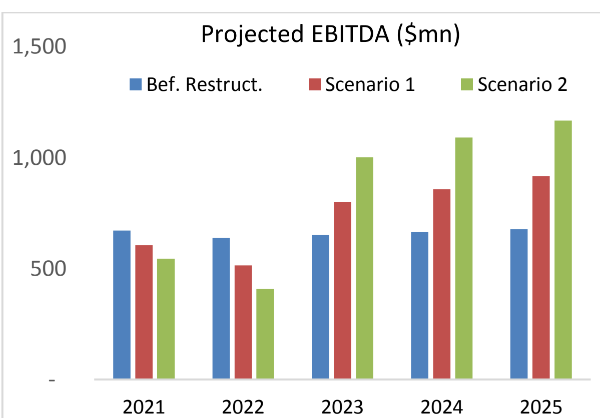
The way the restructuring plan is presented will vary according to the context – e.g., cabinet deliberations v. public consultation – and specific audience. The audience typically includes government officials, SOE management and directors, trade unions and employees representatives, the private sector and civil society. However, when presenting the restructuring plan, a key element to include will be the SOE’s financial projections (or “business plan”) including projected revenues, net income, cash flows, and net debt, and corresponding key financial ratios.

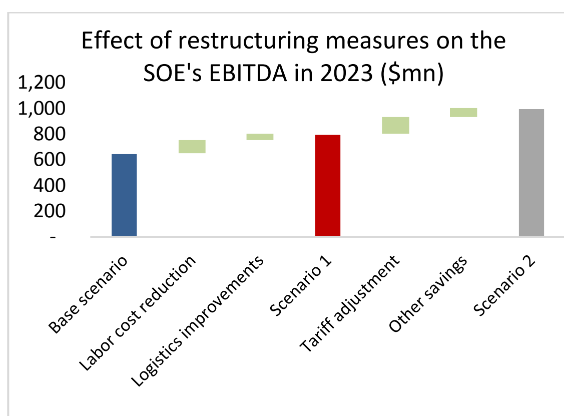
The business plan is the translation of the restructuring actions and key assumptions into the SOE's projected revenues, costs and cash flows. Providing a different set of medium-term scenarios for at least the next five years will show the extent to which the restructuring measures would improve the SOE's performance and financial outlook. In many cases, a slide presentation – including graphs and charts showing the SOE's financial history and business plan of the restructured SOE – will be the best-suited format (Annex 7).

The content of the restructuring plan will also vary depending on the types of issues the SOE faces, the country environment and the scenarios envisaged to turn the SOE around. The following elements are particularly important:

The presentation would typically include a summary of business performance before and after restructuring to show the future aggregate effect of the restructuring measures (see Figures 2 and 3). A sample template for an SOE restructuring plan and a case study for a restructured national airport is provided in Annexes 4 and 6).

Figures 1-2 – Example of Presentation of the Effects of Restructuring on an SOE's Profits (mock data)





4.3. IMPLEMENTING, MONITORING, AND EVALUATING THE PLAN

As with private enterprise restructuring, SOE restructuring aims to achieve some quick successes, but typically represents a medium- to long-term process, possibly taking up to ten years to complete. In many cases, it can be a permanent continuing process. It requires careful and detailed planning, continuous monitoring and evaluation, and fine-tuning as necessary during implementation. It makes sense to appoint a restructuring implementation team to oversee the process and to continue the process of consulting stakeholders as changes take place. Difficulties will inevitably arise, and it will take thorough analysis, regular consultation, and good judgment to decide when it is best to persist with the original plans and when to make adjustments to planned actions or their timing. Continuous evaluation of results is also necessary to assess the extent to which the desired benefits are being achieved and whether the unfolding costs are in line with the original projections.

Responsibility for the preparation, implementation, monitoring and evaluation of the restructuring plan can be assigned to a specialized agency, which might also be in charge of privatization. Establishing a dedicated restructuring agency, where one does not already exist, can be particularly useful when large-scale, systemic restructuring within the SOE portfolio is planned, requiring the development of a prioritized SOE restructuring program linked to a broader SOE reform agenda.

The benefits of a dedicated structure are similar to those of creating a central entity for SOE ownership and include

- ***Enabling the development of in-country capacity***, for designing and implementing consistent and fit-for-purpose SOE restructuring plans;
- ***Less dependency on outside advisors***, and an increased ability to make effective use of their work; and
- ***Improved coordination among government players and stakeholders***, on all key aspects associated with restructuring (e.g., managing labor and social impacts; managing potential implications for the banking sector; and clearance of cross-arrears among SOEs). In fulfilling its role, the agency needs to work in partnership with the SOEs and the corresponding line ministries. In some cases, the SOE ownership agency itself may be given responsibility for SOE restructuring.

SOE restructuring plans are living documents and, while achieving quick wins in the short term is important, restructuring requires sustained political commitment and effort over time. The restructuring plan needs to be reviewed during implementation and updated as circumstances change, and experience is gained. Adjustments can include accelerating or reducing the speed of implementation, dropping components that are proving to be less effective than others, increasing focus and emphasis on those that are proving to be more successful, and adding new components or adopting alternative options to address factors that have become apparent only since the start of implementation. The case studies presented in Annexes 1–5 illustrate both the long-term nature of restructuring and the need for a continued effort

Finally, in any SOE restructuring exercise, it is wise to acknowledge the inherent risks. An ambitious plan may produce mixed or partial results, or even fail. At such times, it may be necessary to consider alternatives to restructuring or to develop a new restructuring plan from the ground up. Given that SOEs worldwide have doubled their importance over the last decade, with assets now accounting for an estimated US$45 trillion, or around 20 percent of the assets of the world's largest corporations (IMF 2020), state ownership of enterprises is likely to prevail in many partner countries for the foreseeable future. The need for SOE restructuring capacity and know-how is likely to grow, rather than decline.

ANNEX 1. CASE STUDY: THE GAMBIA'S NATIONAL WATER AND ELECTRICITY COMPANY

The National Water and Electricity Company (NAWEC) is a vertically integrated SOE responsible for The Gambia's power, water supply and sewerage services, and therefore plays a critical role in the country's economy. NAWEC is also by far The Gambia's largest SOE, with revenues equivalent to 5% of GDP – almost a half of the entire SOE sector's revenues – and assets totaling more than a quarter of all SOEs.

NAWEC has historically represented a significant fiscal burden, but recent financial and operational results have the potential to put the utility on a positive reform path. **The turnaround of NAWEC into an efficient, credit-worthy and financially viable utility is a key component of The Gambia's vision of universal access to affordable clean energy.** The Energy Sector Roadmap, approved by the Cabinet in October 2017, casts a vision to modernize the energy sector and transition to full-time ("24/7") electricity access for all Gambians. The roadmap anticipates shifting the energy mix from 100% Heavy Fuel Oil to lower cost and cleaner energy, through imports from the West Africa Power Pool and private sector investments in the form of domestic independent power producers in renewable energy such as solar.

In the years preceding the designation of the new government in 2017, NAWEC registered losses in the range of $10 to 20 million per year. This was primarily driven by tariff levels which did not allow NAWEC to cover its costs, but also by operational inefficiencies within NAWEC. In 2014, the Government was forced to assume the servicing of NAWEC's debts, adding over 3% of GDP to the budget. In 2015 and 2016, government fuel purchases on behalf of NAWEC cost $20 million per year, while the government serviced about one-third of the company's debt. NAWEC reported a negative equity (deficit in net assets) of close to 5 billion Gambian Dalasi (GMD) – equivalent to approximately $100 million – at the end of 2018 (see Table A1 below).

Since 2017, NAWEC leadership and the Ministry of Petroleum and Energy have embarked on an aggressive reform journey and achieved important milestones in operational and financial performance, as well as important changes to the governance of NAWEC. The key measures and associated results are highlighted below.

<u>Operational reform highlights:</u>

- ***Transmission and distribution losses were significantly reduced***, from 28 percent in 2015 to 20 percent in 2020.
- ***Generation capacity was expanded*.** Available generation in the Gambia increased from 27 MW in September 2017 to 80 MW in early 2021, sufficient to meet peak demand of 70 MW.

- ***System wide blackouts reduced*,** from 45 per month in 2018 to 11 per month in 2021.
- ***Electricity sales grew on average 13% per year over the period 2017-2020***, increasing from 230 GWH in 2017 to 335 GWh in 2020.
- ***Bill collection rates have improved steadily***, from 89% in 2018 to 96% in 2020, primarily achieved by replacing old uncalibrated credit meters for new prepayment meters.

Financial reform highlights:

- ***NAWEC debt* was *reduced by 75%,*** through (i) converting debt to equity; and (ii) government assumption of debts.
- **A *cross-arrears clearance memorandum of understanding was signed with the government*.** It helped NAWEC collect what public sector customers owed it.
- ***Public sector customers were switched to prepayment meters.*** The clearance of arrears has been followed by measures to prevent the buildup of future arrears. The majority of NAWEC's public sector customers are now being supplied through prepayment meters. For critical customers such as hospitals, the military, and the Office of the President, a cash allocation earmarking system now ensures that their bills are paid. Bills for street lighting have been centralized and are now paid directly by the Ministry of Finance.
- ***A new electricity tariff methodology was developed in 2020.*** It incorporates several changes to ensure tariffs fully reflect costs, including a transition to a multi-year tariff model, correct treatment of long-term debt, and an automatic pass-through mechanism for fuel costs. A tariff assessment is underway following the new methodology.

Governance reform highlights:

To complement and solidify these reform efforts, several key governance changes have been made, which will help NAWEC to achieve the financial projections presented in the table below. These include:

- ***Organizational restructuring to ensure the right skills are in the right positions***. With support of is Service Contractor, NAWEC kicked off a reorganization process in 2019. As of mid-2021, NAWEC has an entirely new management team, half of which are female, and it has started the process of recruiting the next level of management. Within the utility, two separate business units (SBUs) were created, one for water and another electricity,
- ***A new information management system (IMS)*** will drive significant change in the day-to-day operations of NAWEC and will enable the separation of financial and commercial accounts for each SBU. The new IMS is expected to go-live in the second half of 2021.
- ***Strategic development plan for the period 2019-25***, including a set of 12 key performance indicators (KPIs) on which regular progress reports are submitted

- ***A new performance contract for the period 2021-23***, which includes financial incentives and penalties associated with the KPIs. This builds on lessons from the pilot in 2020. For example, a robust monitoring framework has been established to ensure that KPIs are tracked by an independent party on a regular basis and discussed with high level decision makers to allow for mid-year course correction.
- ***The first ever charter for NAWEC's board of directors (2019)***, outlining more stringent corporate governance practices.
- ***NAWEC's first ever gender policy and gender action plan (2020):*** NAWEC elaborated a comprehensive gender policy, which was complemented by a Gender Action Plan to narrow the gap of female representation in the NAWEC workforce, with a special focus on technical- and leadership positions

Taken together, these measures have already borne fruit, helping NAWEC achieve greater financial discipline. The SOE continuous improvement is evidenced by regular debt service payments enabling credit facility balances to be cleared ahead of schedule. Additionally, despite the negative impacts of COVID-19, NAWEC did not require direct State subsidies in 2019 or 2020.

Table A1: Actual and projected (after restructuring) key financial indicators for NAWEC's 2017-2023 (GMD million)

	2017	2018	2019 (f)	2020 (f)	2021 (f)	2022 (f)	2023 (f)
Revenues	2,820	3,225	4,801	5,995	6,450	6,978	7,548
Net income	18	(266)	(828)	768	1,523	1,933	2,568
NPM%	*1%*	*-8%*	*-17%*	*13%*	*24%*	*28%*	*34%*
Total assets	6,996	7,938	7,937	6,581	11,107	13,138	15,178
Equity	(4,182)	(4,757)	(4,589)	(4,921)	(3,398)	(1,465)	1,013

Source: NAWEC financial statements and financial model – 1 USD = 51.5 GMB at the end of 2020.

ANNEX 2. CASE STUDY: SERBIA GAS COMPANY[6]

Serbia's national natural gas trading, transportation, distribution, and storage company, "Srbijagas", was established in 2005 as a spin-off from a state-owned petroleum conglomerate. As of 2016, it supplied 600 businesses and 90,000 households in 57 municipalities and employed about 1,100 people. The company had stakes in several subsidiaries and associate companies, of which about half were non-core or non-operating businesses. The company had the largest transmission network in Serbia (about 95%). The company's distribution infrastructure was also the largest in the country (about 46%), comprising low- and medium-pressure gas pipelines with accompanying distribution stations.

By 2014, Srbijagas was the most unprofitable SOE in Serbia, with losses of more than €440 million in 2013 and a further loss of €372 million in 2014. In 2015, losses were reduced to around €3 million, and in 2016, a small net profit of around €14 million was generated. The improvements in 2015 and 2016 were due mainly to reductions at that time in the prices paid for gas by Srbijagas. Accumulated losses led to negative equity of €564 million in 2015. There were significant liquidity pressures, driven by high levels of maturing debt and poor collection rates due to the difficulties experienced by the company's major customers, most of whom were state-owned and in financial difficulty themselves. The company's debts were all guaranteed by the state and therefore represented a substantial contingent liability on public finances.

Srbijagas faced several threats from its external environment, mainly increased competition and a currency mismatch between revenues and costs. Competition from alternative energy sources, particularly electricity, was increasing in a context of low customer switching costs and the impending liberalization of the energy market. More than 90% of the company's revenues were in local currency, whereas more than 85% of operating costs – mainly for gas purchases – were in US Dollars, and the cost of the company's unhedged debt was in hard currencies (74% in Euros and 26% in USD).

Srbijagas's poor financial performance stemmed from two main factors: (i) low regulated prices for gas and (ii) many socially driven investments with low economic returns. Many of investment projects were motivated by political and social objectives and were not viable. These issues were laid out in a diagnostic report prepared with support from the World Bank in 2016. The assessment also showed that the company had engaged in several debt-to-equity

[6] Information taken from a report on financial restructuring options prepared for the World Bank by Ernst & Young, July 2016. The reforms undertaking by Srbijagas were supported by the WB's Public Expenditure and Utilities Development Policy Loan (see https://documents1.worldbank.org/curated/en/862611603807809443/pdf/Serbia-First-and-Second-Public-Expenditure-and-Public-Utilities-Development-Policy-Loans.pdf).

conversions which had resulted in Srbijagas acquiring majority stakes in poorly performing SOEs whose activities did not relate closely to the core activities of Srbijagas.

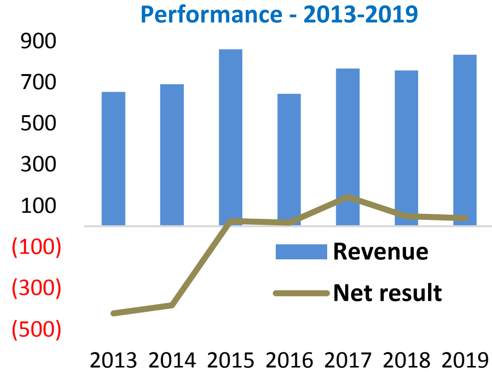
On top of these losses, the SOE's financial position was made worse by recurring receivable collection problems, leading to unsustainable levels of debt. Governmental entities and other SOEs failed to settle their liabilities to Srbijagas, resulting in growing receivables and a liquidity shortage. To finance cash flow shortfalls, Srbijagas resorted to increased borrowing, using loans that were covered in most cases by state guarantees. In several instances, it faced difficulties repaying some of these loans, resulting in many guarantees being called and the loans having to be serviced from the state budget.

The 2016 diagnostic report concluded that maintaining the status quo, with its overleveraged capital structure, liquidity pressures, and competitive and revenue pressures, was not a sustainable option. The report included recommendations intended to transform the company into a commercially viable entity, maintaining the existing business model but increasing gas market sales with a focus on large industrial consumers. It proposed tax and other incentives to promote gas consumption, more stringent environmental laws that would favor gas as a clean energy source, and improvements in corporate governance and organizational and operational efficiency within the company.

To reduce the financial burden of the debt, the report recommended to renegotiate the debt to reduce cash interest rates, extend loan repayment periods, and capitalize some of the debt to the State. It was also recommended to subordinate the government's own claims with respect to other senior debts, thereby reducing the senior debt leverage. Seeking "haircuts" from the creditors was not recommended as it would likely lead to creditor hold-outs due to the government guarantees.

In 2016, the Serbian government accepted the recommendations and adopted and promptly implemented a financial consolidation and restructuring plan. This plan included first a new investment policy with investment criteria based on economic and financial viability. Over the following years, economic performance improved (Figure A2). The receivables collection rate increased from 80 percent in 2015 to 93.3 percent, on average, over the period 2016–18. Outstanding long-term bank loan repayments fell from €657 million in December 2015 to €154 million in December 2018. Divestiture from non-core businesses was not completed, however. The company retained its ownership in seven SOEs that had been its debtors, and the decision on what to do with these investments has yet to be resolved.

Figure A2: Srbijagas Economic Performance - 2013-2019



ANNEX 3. CASE STUDY: SEMRY (CAMEROON)

The Yagoua Rice Development and Modernization Company (*Société d'Expansion et de Modernisation de la Riziculture de Yagoua* or SEMRY) was created in 1971 to build and manage major irrigation infrastructure for rice production in the North of Cameroon. In the early years, this fully state-owned SOE operated irrigation schemes on the Logone River in Yagoua and Maga. Initial results were impressive, with rice produced in SEMRY areas accounting for two-thirds of national consumption. With 1,500 employees, SEMRY supported around 25,000 households and built schools, water supply points, and health centers. Since the late 1980s, however, despite repeated attempts at rehabilitation, SEMRY's operational and financial performance has deteriorated steadily and the area under irrigation has fallen. The original objectives were for SEMRY to provide services enabling the production of around 150,000 metric tons of rice per year, but production has stagnated at 60,000 metric tons per year.

As of early 2020, SEMRY had 450 employees and focused on providing rice farmers with a wide range of services. These include distribution of seeds and other inputs, irrigation and plowing services, operation of a rice mill, bagging, and transport. However, the costs of the services it provides are about twice as high as the revenues it receives. Several recent diagnostic reports identify weaknesses in SEMRY's internal governance, including a bureaucratic organization structure, poor financial controls, and a multitude of outdated operational roles that are legacies of the organization's complex history. Financially, SEMRY depends increasingly on support from the government. SEMRY's greatest financial challenge is its inability to recover the costs of the services it provides. Annual investment subsidies increased from FCFA 6 billion in 2014 to FCFA 12 billion in 2017, while operating subsidies varied between FCFA 0.4 billion to FCFA 1.8 billion over the same period. As a result, SEMRY's liabilities grew steadily from FCFA 0.4 billion in 2013 to FCFA 4.3 billion in 2017, consisting mainly of tax arrears and trade payables.

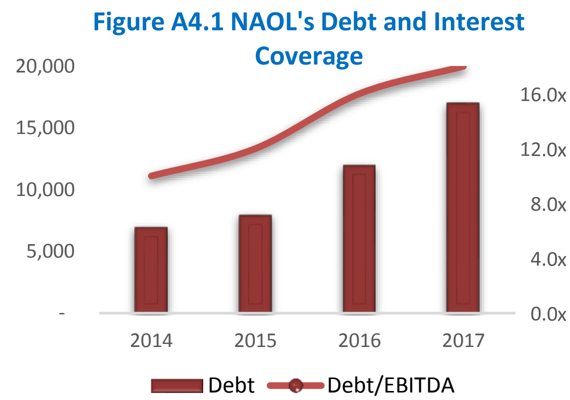
Ambitious restructuring plans have been underway since 2020 to transform SEMRY into a modern water management entity, along the same lines as successful initiatives in other countries. These plans are receiving international support, including from the World Bank's Valorization of Investments in the Valley of the Logone ("VIVA Logone") Project under preparation. A management consulting firm has been recruited to create a detailed implementation plan for SEMRY's transformation. It will include rehabilitation and transfer of the irrigation schemes and restructuring of SEMRY's organization and functions, through a mix of public and private ownership. Producer organizations and commercial companies will take over most of SEMRY's commercial activities, and privately run farm service centers will be set up throughout the producing region. Improvements to the legal and governance framework for land ownership and irrigation management will be implemented. The restructuring will be accompanied by a program to mitigate the social impact of employee retrenchment. A twinning arrangement will also be set up with the Senegalese irrigation agency in the Senegal River Valley (SAED), which has successfully undergone a transformation similar to that planned for SEMRY.

At the end of the transformation, following the divestiture of its commercial activities, SEMRY's residual role will be limited to the provision of essential services, consistent with well-established international practice. Its organization structure will have been downsized and refocused on the maintenance of major infrastructures such as dams and dykes; access roads and major drainage outlets, on support to the newly created water user associations that will manage the irrigation schemes within the irrigation perimeters; on the monitoring of water resources in the Logone River basin, in coordination with national and international authorities; and on training and support to farmers, including the establishment of a new Technology Innovation Center.

Other services will be divested or carried out in partnership with management groups, cooperatives, and private entrepreneurs. These services will include the management of water within the irrigation perimeters, management of the Technology Innovation Center, provision of finance by commercial banks and microfinance institutions, land preparation services, agricultural input supply, management of the rice mill, and rice storage and marketing functions.

ANNEX 4. CASE STUDY: NATIONAL AIRPORT OPERATOR Ltd.[7]

NAOL is a public company with 100 percent of the shares owned by the State government which is responsible for air traffic control. NAOL is also responsible for the maintenance and operation of international and local airports. Passenger and navigation fares and commercial contracts are the primary sources of revenue for NAOL. Additionally, NAOL operates the commercial areas of its airports through rental agreements, vehicle parking fees and advertising fees, among others.



Due to a range of operational challenges and large investments, NAOL's financial situation had become very fragile. The main airport accounts for almost 60% of NAOL's revenues, including domestic and regional flights that account for the largest share of revenues. In a view of extensive investment (about $300 million) in the second largest airport and high levels of indebtedness, the main airport still generated annual losses that included the costs associated with maintaining its status as an international airport. The national carrier's accounts receivable was the biggest obstacle to NAOL's liquidity. Its negative operating liquidity gave a clear indication that NAOL was in a distressed position, with its high debt, negative equity and arrears to creditors.

For the restructuring of NAOL, three possible scenarios were envisaged, combining different variables, including EBITDA, cash flow from operations and debt and financial leverage. The three scenarios included: (a) comprehensive reform - all restructuring options are implemented bringing significant operational improvements and capital increase; (b) partial reform ("in-between" scenario); and (c) status quo – i.e., no restructuring.

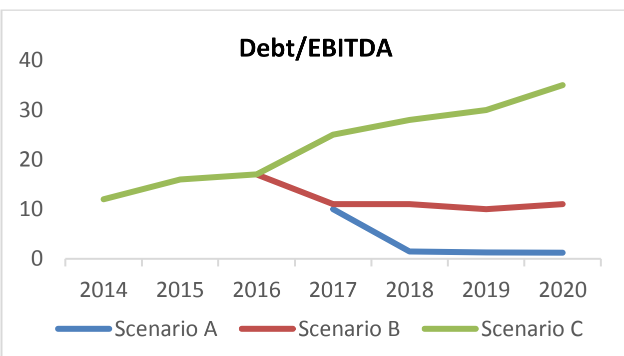
The following measures were considered key to reform the NAOL. Under scenario A the market-based payment practices for billings to the national carrier; capital increase in 2017 (to eliminate the current backlog and leverage); closure of the second airport; 20% cut in personnel costs and contracting services to third parties; and an increase in domestic traffic of 20% in 5 years, and over the same period, non-aeronautical revenue increase of 30%, driven by new players. While under scenario B, no capital increase was considered, and instead of 20 percent, there was a 10 percent cut in personnel costs and contracting services to third parties.

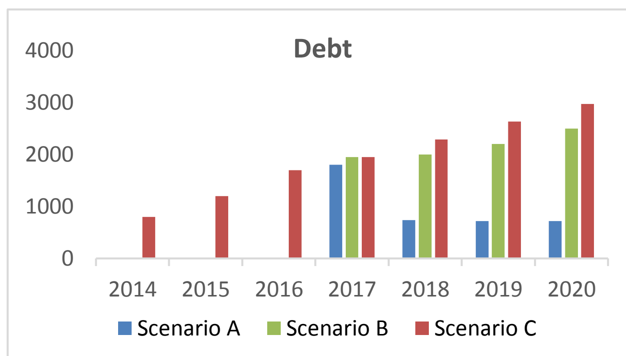
[7] Note: this case study is fictious but based on an actual case. The name of the SOE and relevant facts and numbers have been altered to preserve confidentiality.

Due to the NAOL's situation, which was alarming and risky, the Status Quo scenario could have led to an excessive cost to the government or failure to pay the debt. The inability to meet its short-term debt, combined with the growing financial obstacle arising from operations, was a piece of solid evidence that, without substantial changes, bankruptcy was imminent. Therefore, a capital increase and operational changes could improve NAOL's position and allow NAOL to make a positive contribution to the country's fiscal account. NAOL must increase profitability because higher profits translate into greater liquidity generation. Taking into account all of the key measures under scenarios A & B, Scenario A showed a slight improvement and significantly increases the conversion of EBITDA into liquidity due to the following: the closure of the second airport; cuts in personnel costs and services to the third parties; and as well as the increase of domestic traffic in the next five years along with the increase of non-aeronautical revenues.

Even with a sturdy operational improvement, the generation of liquidity was not sufficient for NAOL's short-term debt service. Therefore, a capital increase was a viable option. Under Scenario A, NAOL's cash flow from operations showed a very significant improvement despite remaining slightly negative (due to interest costs). However, this indicated that measures to strengthen NAOL's balance sheet (including a capital injection) were needed to generate positive cash flows. Under Scenario C (the status quo), the company would continue to generate negative cash flows at a pace that is not sustainable.

Figure A4.2 – Projected Debt and EBITDA under three scenarios (in million local currency)



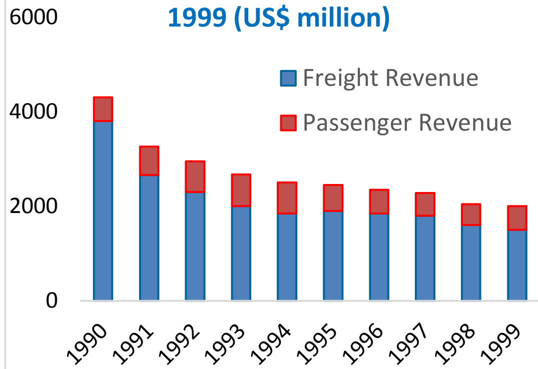


NAOL was unable to pay its debts. Therefore, if no reforms were implemented, debt was expected to increase (Scenario C). The measures implemented under the Scenario A would result in a sharp decrease in debt after one year and would continue at a more sustainable level.

ANNEX 5. CASE STUDY: POLISH RAILWAYS ("PKP")[8]

The Polish State Railways (*Polskie Koleje Państwowe* or PKP) found itself in a difficult financial and operational situation in the early years of transition after the collapse of the Soviet economic system. PKP experienced a sharp decline in revenues (Figure A5), market performance and asset condition. The company had been founded by splitting the legacy rail SOE to align with European Union (EU) standards. A mixed operational productivity and gradual reduction in government subsidies compounded the situation, leading to mounting losses and financial difficulties. Bold reforms of the railways sector were deemed necessary.

Figure A5. PKP's Revenues: 1990-1999 (US$ million)



A first wave of restructuring was carried out in the mid-1990s. Poland passed the first law to reform the railway system in 1995, and a Railway Transport law in 1997 opened the way for sector liberalization. This included allowing private-sector provision of some railway services and opening the track network to third-party domestic operators. Another measure aimed at preparing PKP for joint-stock company ("S.A.") formation and creating separate lines of business.

These measures were complemented by a significant reduction in employment. Total employment fell from more than 245,000 in 1994 to about 200,000 in 1999, thanks to tighter controls on recruitment and early retirement schemes through agreements with the trade unions.

Despite the restructuring measures, the financial performance of the company remained weak, calling for further reform. The PKP group had accumulated significant financial debt, including short-term liabilities to social security and other state duties. The next wave of reforms started with the approval of the PKP Restructuring, Commercialization and Privatization Law in September 2000. The organizational restructuring component of the program led to the establishment in January 2001 of PKP S.A., a holding company with 24 subsidiaries. Employment reorganization continued, leading to the reduction of staff by a further 50,000 employees within

[8] This case study is based on the following papers respectively by the Public-Private Infrastructure Advisory Facility (PPIAF) and the IMF: https://ppiaf.org/sites/ppiaf.org/files/documents/toolkits/railways_toolkit/PDFs/RR%20Toolkit%20EN%20New%202017%2012%2027%20CASE11%20POLAND.pdf and https://www.imf.org/-/media/Files/Publications/DP/2019/English/RRSOECESEEEA.ashx.

two years. These measures were financed through PKP's own funds and borrowing from the EBRD, the World Bank and commercial banks. Debt write-offs were carried out as well.

Changing the organizational structure and improving the governance and management of PKP Group companies was also key to the success of the reform effort. Starting in 2012, PKP undertook several initiatives to improve its corporate governance. Better management at the operational level was achieved by reducing the number of board members at the Group companies. To enhance the effectiveness of corporate governance, audit committees were instituted by the supervisory boards of the subsidiary companies. The overall improvement in management effectiveness increased paid dividends paid by subsidiary companies to PKP S.A. This allowed for a stronger negotiating position in bulk purchase and yielded over US$40 million in savings.

Revenues have recovered after the 2009 financial crisis, and asset sales have help reduce PKP's debt significantly. Both freight and passenger rail market competition has increased, with private operators moving 43% of rail freight and 54% of rail passengers in 2014. New market-oriented management has been appointed, and the workforce has been continuously reduced in response to market conditions. PKP made significant progress in repaying its legacy debt, which decreased from US$1 billion in 2012 to 130 million in 2015.

Overall, Polish railways restructuring is considered a success. The four stated primary objectives – financial and debt restructuring; organizational restructuring; employment restructuring to right-size the workforce; and asset restructuring – were largely met.

ANNEX 6. CHECKLIST: ISSUES TO CONSIDER IN PREPARING AN SOE RESTRUCTURING PLAN

Sector and market context	• Prevailing macroeconomic policies and the economic environment • Budget support policies, reimbursement for PSOs • Competition policy, competitive neutrality, and the presence or otherwise of competitors • Trade and pricing policies • Taxation policies • Labor laws • Sectoral regulation
Legal and institutional framework	• Laws and institutions governing the restructuring process • SOE legal form and structure • Property rights, including land • Collateral, including registries • Courts that oversee insolvency, debt resolution, and enforcement • Legal framework for out of court restructuring • Taxation affecting debt reductions • SOE ownership policy • Early warning systems for SOEs in financial distress • Capacity of the banking system to handle financial restructuring
Appropriateness of SOE objectives	• Ownership policy and rationale for state ownership • Any changed circumstances requiring changed objectives • Potential new or expanded role for the private sector

Financial performance appraisal	• Need to review:
	  ○ the SOE's audited financial statements
	  ○ internal SOE financial reports
	  ○ performance monitoring reports from SOE oversight agencies (if any)
	  ○ reports from the finance ministry and the tax and customs authorities on the history of the SOE's financial relations with government
	  ○ data should cover the last five years
	  ○ budget for the year and business plan prepared by management
	• Calculate a range of financial performance indicators
	• Assess the explicit and implicit impact of SOE operations on public finances

Operational performance appraisal	• Assess the adequacy of operational capacity, performance, and management:
	  ○ Review SOE operational reports
	  ○ key non-financial performance indicators
	  ○ general management
	  ○ management of finance and accounts
	  ○ production management

	○ marketing and distribution management ○ research and development ○ human resources management ○ corporate governance and the role of the board
Reviewing restructuring options and consulting with stakeholders	• Based on the above diagnosis, decide whether restructuring is the best option or whether alternatives such as closure, divestiture, or other avenues might produce better results • If restructuring offers the best chances of success, prepare options for restructuring • Consult on the options with all stakeholders • Review and select the best option(s) based on an assessment of: ○ expected improvements in operational performance and quality of output ○ financial costs and benefits ○ levels of risk ○ potential difficulties and disruptions, including employee resistance to change ○ the best time to launch the process and the speed of implementation • Maximize political commitment: ○ white paper for discussion in parliament ○ communication/public information program
Social impact mitigation	• Carefully target and monitor implementation of mitigation programs • Consider multifaceted programs, for example: ○ extension of medical and other benefits for retrenched employees ○ retraining for new work opportunities ○ assistance in searching for and placement in new jobs ○ new job creation schemes, including through infrastructure development ○ employment subsidies to new employers ○ support for new business startups ○ support for business incubators ○ entrepreneurship training
Implementing, monitoring, and evaluating	• Create an implementation team • Continuously monitor and evaluate results against plans • Continue stakeholder consultations throughout implementation • Adjust plans as necessary, for example by changing the speed of implementation or dropping/adding components

ANNEX 7. TEMPLATE FOR AN SOE RESTRUCTURING PLAN

The structure and content of restructuring plans will vary greatly depending on the country context, sector context, and issues facing the SOE. Below is a broad template of components that might be incorporated.

1. Executive Summary
2. Introduction
    - Background, context, objectives, and processes followed in preparing plan
    - Plan structure
3. Situation analysis
    - Operating environment
        - Market prospects, competition, government policies, legal and regulatory requirements
    - Company profile
        - Finances
        - Markets and customers served
        - Products and/or services
        - Physical assets, production facilities
        - Human resources
        - Business model
    - Historical performance
        - Financial
        - Operational
    - SWOT analysis and summary of issues hampering performance
4. Objectives of Restructuring
    - Improve financial viability, reduce burden on public finances
    - Improve quality of product or service delivery
    - Extend or re-target customer base
5. Options considered for restructuring the SOE
    - Processes followed in reviewing options
    - Brief summary of each option considered
6. Selected Option
    - Reasons for selection
    - Planned measures
        - Change of business model or processes
            - Markets
            - Product range
            - Technology base

- Financial restructuring
  - Increase revenue
  - Reduce costs
  - Restructure debt
  - Recapitalize

- Operational restructuring
  - Improve operational efficiency
  - Capital investment
- Organizational restructuring
  - Mergers, acquisitions, divestments
  - Changes to the management structure
  - Changes in performance management
  - Changes in the management of finances, marketing, production, human resources

- Risk factors and accompanying actions
  - Uncertainties in markets, revenues, costs, or government policies
  - Potential resistance to change
  - Planned social mitigation measures
  - Measures to gain public and political support

- Business plan with outcomes under key scenarios
  - Expected results
  - Implementation schedule

- Institutional arrangements
  - Creation of an implementation team
  - Monitoring and evaluation mechanisms
  - Continued stakeholder consultations

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November 2024

GUIDANCE NOTE ON THE FINANCING ASSURANCES AND SOVEREIGN ARREARS POLICIES AND THE FUND'S ROLE IN DEBT RESTRUCTURINGS

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The Report prepared by IMF staff and completed on October 31, 2024, has been released.

The staff report was issued to the Executive Board for information. The report was prepared by IMF staff. The views expressed in this paper are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board.

The IMF’s transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities’ policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

October 31, 2024

GUIDANCE NOTE ON THE FINANCING ASSURANCES AND SOVEREIGN ARREARS POLICIES AND THE FUND'S ROLE IN DEBT RESTRUCTURING

EXECUTIVE SUMMARY

Under its Articles of Agreement, the Fund may only provide financing to assist members to resolve their balance of payments problems and restore medium-term external viability and may only do so under adequate safeguards. The Fund's inter-related policies on financing assurances, debt sustainability, and debt restructuring are relevant for restoring medium-term external viability. This note is designed as a reference and primer on these key sovereign debt-related Fund policies. It focuses on how to establish that a program is "fully financed" (i.e., the financing assurances policy), how to handle arrears owed by a member to its official and private creditors (i.e., the lending into arrears policies), and how to establish safeguards for continued Fund lending at the stage of program reviews (i.e., financing assurances reviews). It also provides guidance on the more general role of the Fund in debt-restructuring situations. It is the first comprehensive operational guidance on these policies, replacing the guidance previously available at the departmental level. The relevant Fund Executive Board Decisions remain the primary legal authority on matters covered in this note.

Approved By Yan Liu and Ceyla Pazarbasioglu

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INTRODUCTION

1. Under its Articles of Agreement (the "Articles"), the Fund may only provide financing to assist members to resolve their balance of payments (BOP) problems and restore medium-term external viability, and may only do so under adequate safeguards.[1] In other words, Fund financing can only be provided in support of a member's economic policies that are capable of resolving the member's BOP problems and restoring medium-term external viability over a timeframe consistent with the revolving nature of Fund financing.[2] A combination of policy adjustment and new financing from public and private sources has been sufficient to meet this standard in the vast majority of Fund-supported programs. Indeed, Fund financing plays a prominent role in catalyzing donor financing, particularly for low-income countries (LICs) that may not have access to international debt markets even in normal times. The catalytic role of Fund financing, however, is put to the test in cases where members with significant external indebtedness have lost—or are losing—market access.

2. The Fund's inter-related policies on financing assurances and debt sustainability are relevant for restoring medium-term external viability:

- The financing assurances policy requires Fund-supported programs to be fully financed, i.e., that there are no financing gaps in the balance of payments. The presence of financing gaps would imply that the adjustment program will fail even if the member were to fully implement the adjustment envisioned under the program.

- Debt sustainability is essential: Lending into an unsustainable public debt situation would by definition fail to restore the member to medium term external viability.[3] Moreover, it would make the eventual restoration of the member's external viability even more difficult and exacerbate the country's debt situation, by adding debt from a preferred creditor to repay other creditors. It would also pose financial and reputational risks to the Fund. Thus, where a member's debt is assessed as unsustainable the Fund is precluded from providing financing unless the country is taking steps to restore debt sustainability. This is a determination that is not taken lightly.

[1] See Articles I(v) and V, Section 3(a), which require the Fund to adopt policies that will assist members in resolving their BOP problems and that will establish adequate safeguards for the temporary use of the general resources of the Fund.

[2] Guidelines on Conditionality, Decision No. 12864-(02/102), September 2002, as amended.

[3] An unsustainable public debt burden will—with high probability—lead to an unsustainable external debt burden, and vice versa. When public debt is unsustainable and fiscal adjustment is at its maximum, domestic debt restructuring would likely be infeasible (it would hit the same balance sheets that can be targeted through fiscal adjustment), leaving external debt unsustainable. When external debt is unsustainable, stress tends to be transmitted to the domestic side through fiscal adjustment and financial markets, with domestic debt markets involvement of non-residents also playing a key role. See the LIC DSF and SRDSF guidance notes for more details on how the two frameworks capture external debt sustainability considerations.

- The Fund determines that debt is unsustainable when sustainability cannot be achieved through credible and sustainable policy adjustment and/or sufficiently concessional lending from all sources. Restoration of sustainability could be achieved, for example, through the provision of even more concessional financing, and/or through the completion of a debt restructuring. Where an upfront restoration of sustainability via a debt restructuring is not feasible, the Fund can still lend under appropriate assurances that the member is on track to complete a restructuring and restore sustainability on a forward-looking basis.

3. The Fund's arrears policies need to be satisfied. The Fund encourages members to stay current on their obligations to the extent possible, given that accumulation of arrears to external creditors is destructive to national and international prosperity. The presence of arrears can also be a symptom that the BOP problem is not being resolved. However, if program financing assumptions and debt sustainability are achieved, and certain conditions are met, the Fund can lend into arrears. There are also cases where the application of the arrears policy itself is essential for establishing that program financing will be in place and debt will be sustainable.

4. This note provides guidance to staff on the application of these various policies. Special attention is directed to their application to requests for the use of Fund resources from members whose debt has been assessed to be unsustainable.[4] This is the first comprehensive guidance note on these policies and replaces earlier staff-level guidance. This guidance note does not cover other debt-related policies, such as the Debt Limits Policy and the Debt Sustainability Frameworks for Market-Access and Low-Income Countries, all of which have their own dedicated Guidance Notes; and the Fund's Exceptional Access Policies.[5] It also does not cover specialized debt topics, which may be found in other Fund papers.[6]

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[4] In general terms, public debt can be regarded as sustainable when the primary balance needed to at least stabilize debt under both the baseline and realistic shock scenarios is economically and politically feasible, such that the level of debt is consistent with an acceptably low rollover risk and with preserving potential growth at a satisfactory level. See, Review of the Debt Sustainability Framework for Market Access Countries, January 2021. Equivalently, debt can generally be regarded as sustainable when there is a high likelihood that a country will be able to meet all its current and future financial obligations. This implies that the debt level and debt service profile are such that the policies needed for debt stabilization under both the baseline and realistic shock scenarios are politically feasible and socially acceptable, and consistent with preserving growth at a satisfactory level while making adequate progress towards the authorities' development goals. See Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries, December 2017.

[5] Reform of the Policy on Public Debt Limits in IMF-Supported Programs, Nov. 2020; Guidance Note On Implementing The Debt Limits Policy In Fund Supported Programs, May 2021; Review of the Debt Sustainability Framework for Low Income Countries: Proposed Reform, Oct. 2017; Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries, Feb. 2018; Review of The Debt Sustainability Framework For Market Access Countries, Feb. 2021; Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for Market Access Countries, Aug. 2022; and Supplement to 2018 Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries.

[6] For example, Collateralized Transactions: Key Considerations for Public Lenders and Borrowers, Feb. 2020; Collateralized Transactions: Recent Developments and Policy Considerations, Dec. 2023; The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors—Recent Developments, Challenges, And Reform Options, Oct. 2020; Fund Support for Debt- and Debt-Service-Reduction Operations, Mar. 2021; Issues in Restructuring of Sovereign Domestic Debt, Dec. 2021; Debt-for-Climate Swaps: Analysis, Design, and Implementation, Aug. 2022 and Debt for Development Swaps: An Approach Framework, August 2024.

5. This note also covers the more general role of the Fund in sovereign debt restructuring situations. The Fund does not involve itself in the details of debt restructurings, with the notable exception of determining the envelope of debt relief needed for the Fund to assess debt as sustainable. However, its policies for helping resolve a debtor's BOP problems and restoring it to medium-term external viability set important incentives for debtors and creditors to resolve unsustainable debt situations. Fund staff are also guided by several over-arching principles in the context of a restructuring. This is the first time that guidance on the role of the Fund in debt restructuring situations is articulated in a single public document. It is hoped that this transparency can help incentivize further progress towards smoother debt resolutions where it is needed.

6. This note is structured as follows. Section II covers the Fund's financing assurances policy. Section III discusses the Fund arrears policies, covering when an arrears policy will apply, and which specific arrears policy applies depending on the nature of the claim and creditor. Section IV discusses how to apply the arrears policies. Section V discusses when and how to conduct financing assurances reviews, and Section VI details the role of the Fund in sovereign debt restructurings.

FINANCING ASSURANCES

7. There are two different ways in which the Fund needs "financing assurances." The first concerns the assurances required in every Fund arrangement that the Fund-supported program will be fully financed, i.e., there are no balance of payments financing gaps. The second refers to the small subset of Fund arrangements where debt is unsustainable, and financing assurances are required to ensure that—through a debt treatment and/or new financing from other creditors—sufficient financing will be provided to ensure debt sustainability on a forward-looking basis. These are discussed in this section. Note that, in certain circumstances, the Board must complete a dedicated "financing assurances review" (Section V, below) to confirm the existence of financing assurances at each request for Fund resources during the program period.

8. All Fund-supported programs must have full external financing. A Fund-supported program for a member is a combination of adjustment and external financing to eliminate balance of payments financing gaps and restore medium-term external viability. Once the amount of adjustment is set, the full external financing needs are determined.[7] This external financing can come from a number of sources including assumptions regarding a member's expected financing from official and private sector creditors (including (re)gaining market access, if relevant), as well as any debt restructuring envisaged by the member.

9. Financing assurances are required any time a member is requesting a Fund-supported program and at each subsequent review during the program. This policy applies to Fund-supported programs providing financing from the Fund's General Resources Account (GRA) and the Poverty Reduction and Growth Trust (PRGT) as well as to those supported by the Policy

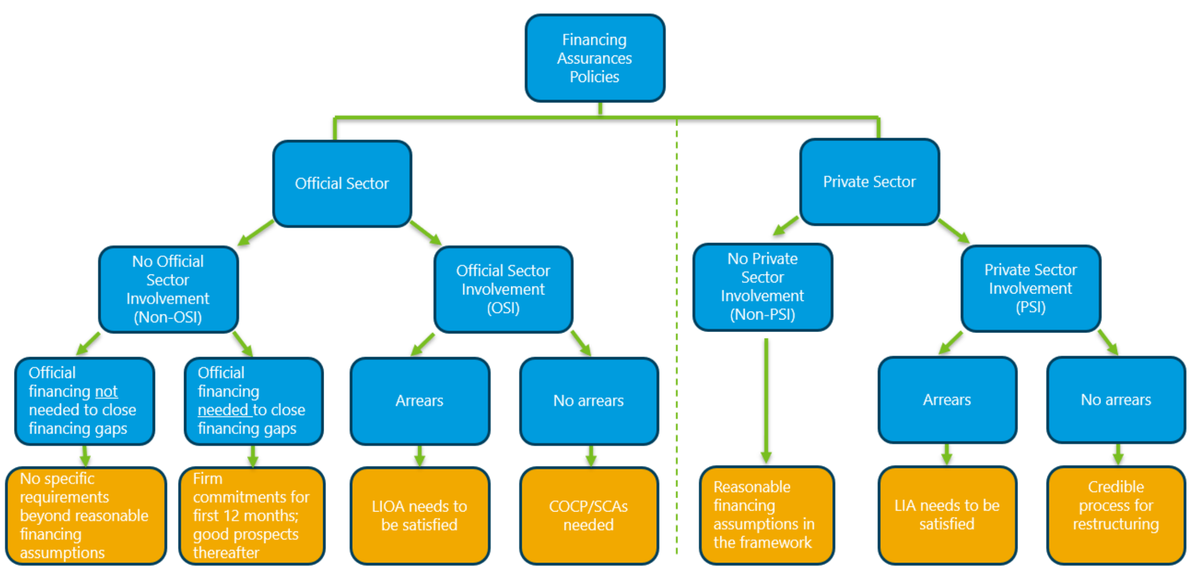
[7] The macro framework underpinning the program will take into account both that adjustment and the amount of financing facilitating that adjustment.

Coordination Instrument (PCI). It also applies when debt restructuring is pursued in the context of a stand-alone emergency financing request (i.e., under the Rapid Credit Facility (RCF) and Rapid Financing Instrument (RFI)).

10. Financing assurances requirements do not apply in the following circumstances:

- Stand-alone emergency financing with no debt restructuring (i.e., under the RCF and RFI). Standard financing assurances do not apply because there is no underlying Fund-supported economic program.
- Staff-Monitored Programs (SMP) and Program Monitoring with Board Engagement (PMB).
- Support under the Flexible Credit Line and the Short-term Liquidity Line where pre-qualification criteria provide the Fund with a safeguard that a financing gap will not develop.
- Reserve tranche purchases (i.e., purchases within the first 25 percent of the member's quota).
- Use of SDR holdings.
- Support from the Resilience and Sustainability Trust (RST). Financing from the RST is only provided alongside a Fund-supported program where financing assurances would already be satisfied.

Figure 1. Financing Assurances Policies



A. Basic Requirements

11. Under the financing assurances policy, the Fund must be satisfied that program financing is adequate to fill external financing gaps. This is understood to mean: (i) during the program period to ensure external viability (comprising the first twelve months, and then the remainder of the program); as well as (ii) during the post-program period to ensure that the member is in a position to repay the Fund.

12. With respect to new financing during the program period:

- Assumptions regarding financing from the **private sector** do not need to be supported by assurances but must reflect reasonable expectations based on the evolving conditions. Staff should explain the basis for projections and in this context could draw on the terms and conditions of recent issuances/loans (including for peers), and scope for additional creditor exposure to the country (based on historical experience, or direct consultations with market participants). Such analysis should take into account the authorities' readiness to issue at prevailing/expected market conditions, and the likely market response to the policy adjustment pursued. In a restructuring context, staff should draw on research concerning the timing, terms and conditions of market re-access.[8]

- For the **official sector**, the Fund requires that: (i) "firm commitments" of financing must be in place for the first twelve months of the arrangement; and (ii) there must be good prospects for adequate financing for the remaining program period beyond the first 12 months. These cover not only loans, but also any grants needed to close financing gaps, and may cover other types of committed financing (e.g. equity investments or non-OSI rescheduling of existing claims). Importantly, assurances on financing from the official sector for the upcoming 12-month period (or whatever period of the program remains) must be ascertained on a rolling basis. Specifically, the "good prospects" must become "firm commitments" or actual financing. In practice, several issues can arise in making these judgments:

    - The way such commitments are provided by official creditors varies, and whether they are characterized as "firm" is a matter of judgement, informed by past collaboration with that creditor/donor. For contributions from official bilateral creditors, staff should draw on the authorities' representation, following up directly with creditors where further clarity is needed. Staff should reach out early to creditors to help determine the nature of their commitment.

    - Commitments must be considered credible, and the Board would make that assessment advised by management and staff. To this end they may be sought in writing but are not required in such a format.

    - Creditors' assurances and commitments are reflected in program documents, which will be eventually published. Where sensitivities may arise, staff should make sure this is understood.

[8] Timing, terms, and conditions of market re-access depend on whether the debtor restructures preemptively (without a default) or after missing payments (default), and the outcome of the debt restructuring (NPV haircut) (Asonuma and Trebesch 2016, Cruces and Trebesch 2013).

- Different types of financing (e.g., grants vs budget support loans vs project financing) have different implications for the BOP, which need to be taken into account when assessing whether the financing gaps are closed. For instance, project financing support can entail a high import content with little net benefit to the BoP.

- Official creditors may set conditions on upcoming financing. In order to consider that such commitments are "firm", staff must be satisfied that the conditions are on track to be met such that the financing will be provided as scheduled.[9]

- When commitments are signaled by **IFI financing partners** with a track record, and are in specific amounts (or ranges), such commitments are deemed to meet the "firm commitments" standard. In this context, in practice, commitments from the World Bank may be conveyed at the staff level (after cleared by its Management). For commitments required from IFI financing partners without a substantial track record, the firmness of the commitment may need to be further examined and assessed. Where commitments from partners without a substantial track record are reduced within a program, then written communications for further commitments may become appropriate.

13. With respect to the post-program period: staff needs to assess whether the member's prospective policies deliver a projected post-program macroeconomic performance that adequately safeguards repayments to the Fund consistent with a sustainable debt path. This manifests in a slightly different ways in different Fund lending contexts:

- A Fund-supported program in the Fund's GRA or under a Stand-by Credit Facility arrangement under the PRGT is designed to restore the member to medium term external viability and resolve the BOP problem. That is, the policy measures needed for this purpose should be undertaken during the program period. As long as obligations to the Fund are outstanding, staff needs to judge that there are no financing gaps in the post-program period both at arrangement approval and each subsequent program review. Where relevant to the member, staff would need to assess, based on a realistic macro-framework and the Debt Sustainability Analysis (DSA), that the member has good prospects for (re-)gaining access to capital markets at sufficient depth, maturity, and price to ensure capacity to repay the Fund and consistent with a sustainable debt path, taking into account all sovereign maturities falling due in the post-program period as long as repayments to the Fund are outstanding.

- Under Extended Credit Facility (ECF) arrangements under the PRGT, the member's protracted BOP problem does not need to be resolved within the program period.[10] However, any financing gaps in the post-program period for an ECF arrangement need to be such that, notwithstanding the fact that sources to fill the gaps have not yet been identified, the Fund is assured that the

[9] If an adjuster is used, reflecting timing uncertainties, it does not alter the requirements on full financing assurances covering the baseline.

[10] This is particularly true for fragile and conflict-affected states. See Staff Guidance Note on The Implementation of The IMF Strategy for Fragile and Conflict-Affected States (FCS).

member has the capacity to repay the Fund (irrespective of a successor arrangement), and that any gaps are consistent with a sustainable debt path.

B. Additional Requirements in a Pre-Emptive Restructuring Context

14. In case the Fund-supported program cannot be fully financed with new financing from the official or private sector, the Fund will need assurance that creditors' claims will be restructured on sufficiently deep terms to restore BOP viability. There may also be cases where, although a program appears fully financed, a debt restructuring is needed to restore debt sustainability over the medium term.[11] In either case, financing assurances address the need to restore debt sustainability and/or the need to ensure that the program is fully financed. The policy does not prescribe the allocation of financing to be provided (through new financing and/or debt restructuring) between official and private creditors (although the allocation would need to be such that intercreditor equity concerns do not undermine the judgment that the restructuring will be successful). The policy also does not require a specific sequencing of financing assurances from official versus private creditors and can accommodate simultaneous processes. Sequencing choices are made by the authorities and their advisors, in consultation with creditors.

Contributions From Official Bilateral Creditors

15. Staff must assess that a "credible official creditor process" (COCP) is in place for all relevant creditors and that the "key stage" in their process(es) has been reached. This is understood as signaling that debt relief will be delivered promptly.[12] Essentially, the Fund must be confident that the decision has effectively been made to provide a treatment consistent with program parameters, even though the actual delivery may only come after further domestic steps have been taken. In order to make this judgment, staff should understand, for each such creditor, (i) the steps in the official bilateral creditor's internal process; (ii) the key decision-makers involved (i.e., those with authority to commit the creditor); (iii) the creditor has been provided the necessary information to understand the depth of the needed treatment and the creditor's share (i.e., macroeconomic outlook, debt targets, possible restructuring approaches); and (iv) the timeframe over which the treatment would be expected to be executed (which should be in line with the Fund's expectation that the key terms of a restructuring would be agreed promptly, normally by the time of the first program review). Appendix IV illustrates the concept of COCP. Staff should interact with the creditor and support its internal process, by providing information on a timely basis upon request and responding to creditor inquiries (see Appendix VIII).[13]

[11] An example of this would be Greece (2010), where the Fund-supported program was fully financed but debt remained unsustainable in the medium- and long-term.

[12] Policy Reform Proposals To Promote The Fund's Capacity To Support Countries Undertaking Debt Restructuring, April 2024.

[13] Consent of the debtor must be sought, and in this context the debtor must be informed that the Fund cannot proceed with a program without financing assurances.

16. There are several nuances to consider in a COCP judgment:

- Whether the "key stage" in the COCP has been reached (i.e., the decision to provide relief has effectively been made) will be creditor-dependent and will require judgment in the context of a specific country case. As experience is gained with individual creditors and a track record has been established (allowing identification of the key stage of decision making, including the nature of each decision and who took it), staff should defer to the creditor authorities' representation that this key stage has been reached. A track record can arise from delivering outcomes (i.e., contractually finalized debt relief and/or provision of new financing consistent with program parameters).

- The assessment of whether the "key stage" has been reached may vary even for a given creditor depending on the type of treatment being sought from creditors. For example, a creditor may have a longer track record for NPV-neutral reprofilings than for deeper treatments. Other creditors may already have an extensive track record spanning a wide range of treatments. In the event that a debt treatment is not delivered in a timely manner, or at all, staff would need to revisit the assessment of the "key stage" in the COCP for the relevant creditor (impacting future cases). The Strategy and Policy Review Department (SPR) and the Legal Department (LEG) should be consulted on the most recent information to feed into this assessment for any creditor.

- Where an official creditor coordination mechanism is being used—such as the Paris Club or the Common Framework (CF)—the features and track record of that mechanism's processes should be taken into account. For treatments by the Paris Club, the "key stage" of the process is a preliminary indication that the Paris Club is willing to provide debt relief in anticipation of an Agreed Minute. That assurance is derived verbally from the chair summing up at the end of the Paris Club meeting where the working paper for the treatment is discussed. For treatments under the CF, the assurances can also be derived in a similar verbal fashion based on the creditor committee co-chairs' summing-up when the creditors meet to discuss the need for and broad contours of the required treatment.[14]

17. In the absence of a sufficient track record to determine that a "key stage" had been reached in a creditor's COCP, the required determination can be made via receipt of a *"specific and credible" assurance* on debt relief/financing. The modality of this type of assurance is within management's discretion, although a written communication from the creditor is preferred. In substance, this assurance should be received from an individual in a position to commit the underlying creditor, should show an understanding of the debtor member's situation, and should

[14] This discussion would be expected to be based on a working paper or other background document that sets out the macroeconomic situation and outlook of the debtor country, clarifies the current debt position, and identifies the scale of the BOP financing gap and aggregate debt relief necessary to restore debt sustainability.

commit to the needed actions to restore debt sustainability and financing in line with program parameters.[15]

18. Financing assurances are needed from a "sufficient set" of official bilateral creditors. A "sufficient set" must account for the majority (above 50 percent) of the total financing contributions required from official bilateral creditors over the program period and must include any standing creditor forum if applicable and any creditors with influence over the debtor. The remaining creditors would be considered not material for the purpose of the assurances and would be assumed to restructure on program terms. As regards creditors with influence:

- These would generally include those with the ability to extract repayment on more favorable terms inconsistent with program parameters. Indicators of this would include enforceable and economically meaningful collateral or collateral-like features in the debt contract with the creditor that could significantly complicate a restructuring; the creditor's share in the total debt stock or debt service flows being high (e.g., among the top three creditors); or a situation where the debtor's total BoP relationship with the creditor country (trade and capital flows) is high (e.g., in the top three countries over the previous five years). However, case-specific mitigating factors also need to be assessed, for instance the inherent flexibility in the debtor country's trade (e.g., because the country has alternative sources of supply or demand in theory); or whether the collateral is playing a positive role (i.e., "related" collateral that would directly generate repayment capacity).

Debt Relief from Private Creditors

19. Where such debt relief is expected to come at a date beyond arrangement approval, assurances are derived from the Fund's judgment that a credible process for debt restructuring is underway.[16] Such a "credible process" would result in sufficient creditor participation to restore debt sustainability and close financing gaps consistent with the macroeconomic parameters of the program, taking into account official sector commitments. This judgment will depend on member-specific circumstances, but relevant considerations to form such judgment include: (i) prompt engagement of legal and financial advisors by the member; (ii) launching of consultations with creditors; and (iii) design of the debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation. The Fund's primary focus should not be on the specific design of the restructuring, but rather on whether the process is credible, and that it is likely the restructuring will garner sufficient creditor participation and deliver sufficient relief to restore debt sustainability in line with the program.

20. There are timing expectations that have been articulated by the Executive Board. The debt restructuring should ideally be undertaken before the approval of the Fund arrangement, while

[15] One example of such assurances would be for the creditor to state that it supports the debt treatment in line with the goal of restoring public debt sustainability consistent with the envisaged IMF-supported program and delivered through financial operations negotiated between the creditor and the debtor.

[16] See 2022 Reviews of the Fund's Sovereign Arrears Policies and Perimeter.

still being in line with proposed program parameters. However, there are circumstances where more flexibility is warranted, such as cases where there have been delays notwithstanding a credible process to achieve the necessary end result. In these cases, the conclusion of the debt restructuring is contemplated for a later date—normally, by the first review under the Fund arrangement. Against this background, it would not be necessary to hold up Fund financing until there is complete clarity regarding the terms of this operation.[17]

Special Procedures and Requirements

21. In some debt restructuring circumstances, special procedures and requirements for financing assurances apply:

- **Two-step processes.** It is possible for official bilateral creditors to commit to a "two-step process" with an initial flow treatment to be followed by a stock treatment before the end of the Fund-supported program. A two-step approach was followed during the Heavily Indebted Poor Countries (HIPC) process as a way to incentivize debtors to meet completion point triggers.[18] The key features of such a process that allow it to provide a financing assurance include: (i) a well-defined and over-arching framework formally agreed by creditors to apply across cases; and (ii) in individual cases, a strong upfront commitment by the creditors. However, it is important to note that such an approach can create uncertainty and the risk that commercial creditors will also delay their restructuring. As such, it is generally only appropriate in the context of international initiatives, unless very specific circumstances (involving concrete future developments relevant for repayment capacity) would justify this approach.[19]

- **Procedures for members facing "exceptionally high uncertainty".** When a member facing exceptionally high uncertainty seeks an upper-credit-tranche-quality (UCT) Fund arrangement, a specific program design is required, implicating a different approach to financing assurances. Further details on the definition of "exceptionally high uncertainty" and the procedural and financing assurances requirements in such cases are set forth in Appendix I.[20]

- **Approval-in-Principle (for members facing extended delays in obtaining financing assurances).** For a member facing extended delays in obtaining financing assurances, the Fund may choose to approve an arrangement in principle, with the arrangement becoming effective once the financing assurances sufficient to restore debt sustainability are received. The use of Approval in Principle (AIP) of a Fund arrangement may be appropriate when there is full agreement on the member's policies underlying the potential Fund-supported program but

[17] See, The Acting Chair's Summing up—The Fund's Lending Framework and Sovereign Debt—Further Considerations, January 2016.

[18] The Paris Club used the Evian approach, effectively a two-step approach, for debt relief for Iraq.

[19] For example, in the case of Suriname the official sector provided a flow treatment to be followed by a second treatment because of the prospect of revenues from oil discoveries.

[20] Changes to the Fund's Financing Assurances Policy in the Context of Fund Upper Credit Tranche (UCT) Financing Under Exceptionally High Uncertainty, March 2023.

some delay is anticipated in receiving the necessary financing assurances (to allow a framework for engagement with the debtor member) and if it facilitates the dialogue between the debtor and its creditors (e.g., by making public the Debt Sustainability Assessment (DSA) and full details of the Fund-supported program). Further details on this procedure and the associated requirements are set forth in Appendix II.

Staff Report Requirements.

22. For all programs, a clear assessment of whether the program is fully financed should be included in the staff report at every arrangement request and review:

- The staff report should specifically identify the sources and timing of expected financing, and whether there are any conditions attached to such financing.
- In the context of an official-sector restructuring, staff reports should state clearly that the key stage of each creditor's (or creditor coordination mechanism's) COCP has been reached. In the event that the Board has never before assessed a "key stage" for a specific creditor's process, this requires that staff explain to the Board the basis for the judgment that the COCP is in place, citing key elements of the process, and that the key stage has been reached based on the creditor's track record. Subsequent cases for the same creditor would not need to repeat the full explanation, absent new developments, but may just refer to the attainment of the "key stage".[21] In the absence of a sufficient track record to determine that a "key stage" had been reached in a creditor's COCP, the staff report must include that specific and credible assurances have been received from a given official bilateral creditor but does not need to repeat the assurances verbatim.
- In the context of a private sector restructuring, staff reports should record staff's assessment that the "credible process" standard is met and provide the basis for the staff's assessment (per paragraph 19). Staff report requirements in the special circumstances identified in paragraph 21 are covered in the relevant appendices of the staff report.

23. Per Fund policy, namely, the Guidelines on Conditionality[22], staff reports should normally only be issued to the Board once staff and management have assessed that all applicable Fund policies have been satisfied. However, in very rare circumstances, management has issued a staff report to the Board prior to receiving financing assurances (or when other Fund policies were not met at issuance). Where such a course is proposed, the determination should be made that issuing the staff report will help in securing the needed assurances. Where financing assurances are outstanding at the time of issuance, the staff report will clearly flag such lack of financing assurances on the cover page prepared by SEC for Board circulation, the staff report will

[21] Please consult with SPR Debt Policy Division on whether a specific creditor's or creditor coordination mechanism's COCP has been previously presented to the Board.

[22] Management may only propose a request for the use of Fund resources to the Board for approval if all Fund policies are met and the member is sufficiently committed to implement the program.

be issued without a proposed decision and without a firm Board meeting date on the cover. Upon receipt of the needed assurances, a supplement assessing that such assurances are sufficient to restore debt sustainability and providing the proposed decision should be issued, and a Board date will be announced.

SCOPE OF THE ARREARS POLICIES

24. When a member is in arrears to external creditors the Fund's arrears policies must be satisfied for the Fund to lend. Recognizing the destructive nature of external payments arrears to both national and international prosperity (see Article I(v)), the Fund encourages members to stay current on their obligations to the extent possible. Consistent with this, since 1970 the Fund has had a general policy on non-toleration of arrears unless a specific policy applies that enables the Fund to lend into sovereign arrears. These specific policies are those on Lending into Arrears (LIA) and Lending into Arrears to Official Bilateral Creditors (LIOA).

25. A key goal of the Fund's arrears policies is to ensure that the member will soon regularize its relations with creditors. This would resolve the arrears and, in a program context, ensure medium-term external viability and securing the financing assurance required for the post-program period. The member may have difficulty in securing an agreement with its creditors on restructuring terms consistent with the parameters of the Fund-supported program (i.e., the balance of financing and adjustment that has been sought by the Fund). The policies enable the Fund to effectively tackle the hold-out problem by removing the veto power from creditors, and their ability to press for terms that are not program-consistent or to delay the process (which involves costs to the member and international community).[23]

26. This section covers when the Fund's arrears policies apply and the circumstances in which each policy applies. In general, they only apply when the Fund is lending its resources and when the member is in arrears to its external creditors (Section A), but the application of the policies depends on the creditor (section B). Lending covers a variety of Fund arrangements including requests and reviews for arrangements under the GRA and any trust instruments, such as the PRGT and RST. The arrears policies also apply to emergency financing under the RFI and RCF. They apply to the non-financing Policy Coordination Instrument by analogy. The arrears policies do not apply to SMPs or PMBs, as there is no Fund financing, although the clearance of arrears should still be encouraged.

[23] Before the Lending into Arrears policy was introduced in 1989, even commercial creditors could have veto power over Fund financing. This can exacerbate collective action problems and be detrimental to creditors as a whole.

A. When Do the Arrears Policies Apply?

27. The arrears policies apply where a sovereign debtor has run arrears on a claim held by an external creditor and that debtor is requesting Fund financing. To take each aspect of this statement in turn:

a. **The debtor generally must be sovereign.** The sovereign, for these purposes, includes all entities whose financial operations form part of the budgetary process of the debtor government (Box 1). However, claims that originally were owed by other public/private creditors may become subject to the arrears policies if they become obligations of the government, for example because a government guarantee (on the debtor side) is called.

   - The one exception to the requirement that the debtor be sovereign is the strand of the LIA that applies to jurisdictional arrears, i.e., non-sovereign arrears that arise from the imposition of exchange controls.[24]

b. **The claim must be in arrears.** Arrears arise when any external payment obligation has not been paid in full at the time it is due, taking into account any applicable grace period or cross-default provision. The existence of arrears does not depend on the magnitude of the amount (there is no *de minimis* exemption), the reason for the nonpayment, the creditor's inaction, or the debtor's (legal) inability to make a payment. The existence of arrears is also not affected by the age of the arrears, so long as the claim remains valid under the governing law. It also is not affected by any additional grace period that may be provided in the member's TMU definition of the external arrears performance criterion. If only some of the claims outstanding are in arrears, the arrears policies will only apply to that subset of claims.

c. **The claim must be to an external (i.e., non-resident) creditor.** The arrears policies always apply based on the residency of the creditor, even where the Fund-supported program (e.g., the external arrears performance criterion) and/or DSA defines debt/arrears on a currency basis or excludes certain claims. Hence, if any portion of a domestic-law debt claim is held by non-resident creditors, the entire issuance/claim falls within the scope of the arrears policy. On residency:

   - For purposes of the arrears policies, the place of legal incorporation governs the residency of entities. For example, a domestic branch of a foreign company would be considered a non-resident, whereas a domestic subsidiary of a foreign company would be considered a resident. The application of the arrears policies may be affected if the residency of the creditor changes—e.g., through sale of the claim or through a guarantee being called. Note that the legal and statistical definitions of residency may not always coincide. How these

[24] Exchange controls for these purposes are limited to measures considered exchange restrictions subject to the Fund's jurisdiction under Article VIII, Section 2(a). Exchange restrictions arise from direct governmental limitations on the availability or use of foreign exchange for payments and transfers for current international transactions. See Decision No. 1034; Fund Policy on Arrears to Private Creditors—Further Considerations, April 1999.

creditors are treated under different aspects of a program—e.g., for the external arrears performance criterion or the DSA perimeter—should be clarified in program documents.

- Currency union central bank (CUCB) claims on members raise unique issues. For decentralized currency unions (the Eurozone), only the claims held by the central CUCB (the ECB) would be considered external; own-sovereign claims held on the national central bank balance sheets would be considered domestic and thus would not be subject to the arrears policies. For centralized currency unions (CEMAC, ECCU, WAEMU), all CUCB claims on a member are considered domestic for the purposes of the arrears policies.

Box 1. Determining Whether Entities are Part of the "Government"

The Fund considers whether an entity's financial operations form part of the government's budgetary process when determining whether arrears *owed by* or *owed to* that entity are "sovereign." In other words, on both the debtor and creditor sides, the scope of the "government" for arrears purposes is determined by inclusion in the budgetary process. That said, claims held by entities outside the government's budgetary process may still be considered Direct Bilateral Claims if they were extended or contracted on behalf of the government.

The financial arrangements of public entities and the relationship of these entities to the central government member are country-specific and based on the domestic budgetary law framework and its interpretation and may differ between members and may need to be examined on a case-by-case basis. As general guidance:

- Ad hoc budgetary support or (occasional) coverage of losses would not necessarily indicate that the entity forms part of the budgetary process.
- Profit transfer from a state-owned enterprise to the central government would also not necessarily mean that the entity forms part of the budgetary process.

In contrast, an entity that is a direct budgetary unit or that receives direct moneys from the budget would form part of the budgetary process. However, some entities that are government-owned may fail these tests, such as sovereign wealth funds, state owned enterprises, and government owned banks (to the extent they operate at arms-length and under commercial principles).

28. The arrears policies do not apply to claims in dispute. The Fund's "disputed claims doctrine" arises from the Fund's duty of neutrality. Where the Fund accepts the member's representation that the *validity* or *amount* of a debt claim is in dispute, a disputed claim does not give rise to arrears for all Fund purposes.[25] Although the Fund reserves the right to challenge a member's representation of a dispute, members are generally granted benefit of reasonable doubt in this regard. In line with this practice, staff has on rare occasions queried whether there was a factual basis for a member to credibly represent a dispute to the Fund. The considerations relevant

[25] If a member does not represent a dispute as to the validity or amount of the claim but merely challenges the characterization of the claim (as a Direct Bilateral Claim or otherwise), Fund staff needs to investigate the nature of the claim for the purposes of applying the Fund's arrears policies. Staff would inquire about the nature of the claim and provide a reading to the two parties based on the evidence. In the event of lingering concerns form either party, any final judgment would rest with the Executive Board. See, e.g., Status of Ukraine's Eurobond Held by the Russian Federation, December 2015 although subsequent developments in litigation led this claim to be reclassified as disputed in 2023.

to staff's queries have included the record of the positions between the debtor and creditor, the record of statements to the Fund, the arguments made in any litigation, and the status of such litigation. The Executive Board makes the final determination of claims in dispute. To introduce a dispute on pre-existing arrears to which the Fund's policies have previously been applied, there should have been a material change in facts.

- Note that while disputed claims do not give rise to arrears for the purpose of Fund policies, such claims are taken into account (as a contingent claim) for purposes of the DSA analysis and could impact the determination of whether debt is sustainable (depending on the size and probability of claims being realized). Where debt is found to be unsustainable adequate assurances would need to exist for the financing of a Fund-supported program.

29. The approach taken by the Fund to establish arrears is not mandated in other areas of Fund program design or creditor interactions:

- The scope of the arrears policies and the scope of any performance criterion (arrears PC) on non-accumulation of new external arrears are not necessarily the same. For example, the arrears PC may apply to a narrower definition of debt, have a different definition of "government," define "external" based on currency or governing law, or provide additional grace periods compared to the arrears policies. Further, while the arrears policies only apply to claims in arrears at the time of Board consideration of a member's request for Fund financing or subsequent reviews, the arrears PC is continuous in nature—in other words, the occurrence at any time during the arrangement of new arrears subject to the scope of the arrears PC will result in the non-observance of the PC. For similar reasons, this scope may differ from that for external debt and arrears as defined in the DSA. See Appendix V for further discussion of the performance criterion.

- The Fund's classification of claims does not determine their treatment in a restructuring. The arrears policies are internal policies for the Fund's operations. They are not intended to drive the negotiation process nor to influence the policies of other creditors. In light of these considerations, the Fund's classification of claims for its own purposes does not always need to align with claims treated in the Paris Club or under other representative creditors fora (e.g., CF). While the Fund uses a claim-by-claim analysis to determine the classification of claims for purposes of Fund policies, for efficiency reasons, the Paris Club often uses an institution-by-institution approach to encompass a broader scope of claims in its treatments. While there are benefits to a close alignment between the Fund's definition and the Paris Club and CF practice, exact one-to-one mapping is not necessary, and the treatment has differed on the margins in the past without any material complications.

Staff Report Requirements

30. Staff report requirements include:

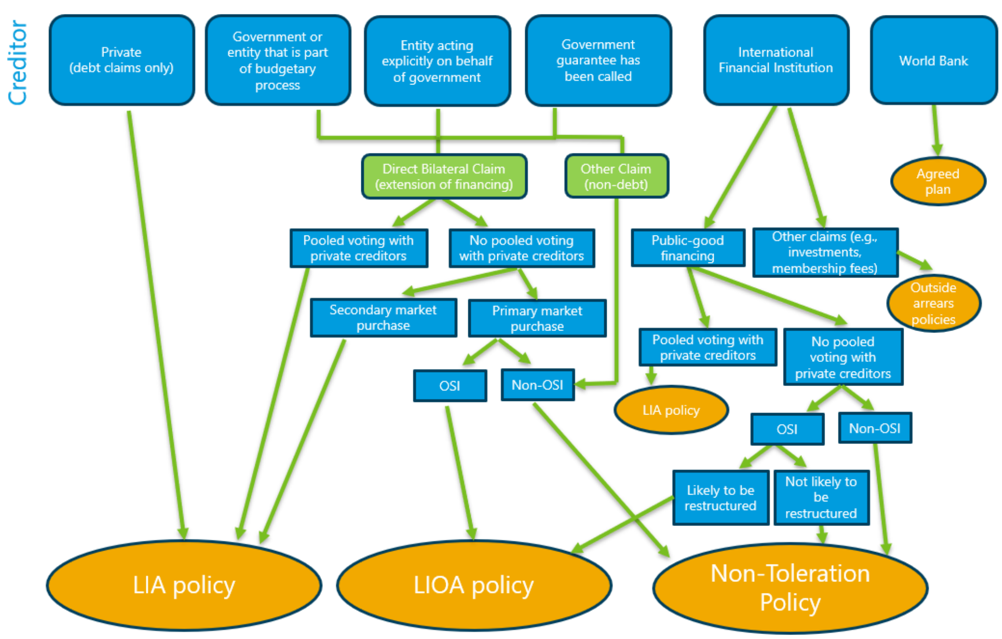
- Staff reports for program cases must identify external arrears, including the amount of the claim, the creditor, and the date when the claim went into arrears, given the implications for the arrears policies and the external arrears PC. Including the above information in surveillance cases would be good practice.
- When the validity or amount of a claim is disputed, as noted above, the first staff report following the representation of the dispute should include a factual description of the claim and basis for the dispute. Subsequently, staff does not need to include a statement in the main text of the staff report—absent material developments—but should continue to include a footnote or other statement that the claim continues to be disputed and include it as a contingent claim in the DSA.

B. Which Parts of the Arrears Policies to Apply

31. Once staff has determined that arrears exist and thus that the arrears policies must be applied, a judgment must be made as to which part(s) of the policies to apply. In all cases, the Board makes the final determination on the advice of management and staff. In order to ensure that the management and staff's proposal is well-founded, early fact-finding discussions with the debtor and creditors (including Paris Club or CF) may be critical.

32. The determination on the application of the arrears policies is done on a claim-by-claim basis. The Fund recognizes several categories of claims, and thus several categories of arrears.

Figure 2. Determining Which Arrears Policy to Apply



Arrears on Direct Bilateral Claims of the Official Sector

33. Direct Bilateral Claims are defined as those claims that are:

- *Held by a government, or an agency acting on behalf of a government and originate from an underlying transaction where the creditor government, or an agency acting on behalf of the government, provided or guaranteed financing to the borrowing member.* As noted in paragraph 27 and Box 1, the "government" is defined as those entities whose financial operations form part of the budgetary process. Note that this includes cases where claims originally extended by non-government creditors may become Direct Bilateral Claims if they benefited from a creditor-government guarantee at the time the claim was extended, *and* this guarantee is called.

- *Central bank swap lines and deposits at the debtor's central bank that are extended on behalf of the government for BOP purposes.*[26] This does not include purchases of sovereign bonds for portfolio or reserve management purposes.

34. The assessment of whether an entity is acting "on behalf of government" should take into account the totality of circumstances of a specific case. Fund staff should seek the representation of the creditor authorities as to whether a claim was acquired on the government's behalf. Where the creditor represents that an entity was acting on behalf of the government, this should be supported by additional evidence. Important elements to consider would be the governance structure of the entity; whether the claim in question originated from explicit directions from the government; and—where relevant—the terms of the financing provided. Staff should also consider whether the creditor's representation has been consistent, both in the context of the specific claim and for similar claims on other countries.

35. There are important exclusions to the definition of "Direct Bilateral Claim" for Fund policy purposes (arrears on these excluded claims are subject to the Fund's LIA policy; refer to Section IV.D)**:**

- **Secondary Market Purchases by Official Bilateral Creditors.** By its terms, the Fund's definition limits Direct Bilateral Claims to those reflecting the provision of direct financing to the debtor government. Thus, only primary market purchases by the creditor government or entities acting on its behalf qualify. This treatment is aligned with the typical motive for such purchases, which tend to be commercial (unlike secondary market purchases of bonds by IFIs which are sometimes conducted with the intent of providing BOP support).

- **All claims that are contractually part of a pooled voting mechanism with private creditors.** An official bilateral creditor's potential participation in more than one voting pool (e.g., holds an instrument subject to the same collective action clause (CAC) as private bondholders and is also a member of the Paris Club or the CF) can complicate both restructuring processes. In recognition of this, bonds with single-series CACs can be treated as a Direct Bilateral Claim only

[26] "Consolidated Executive Board Understanding", pp. 108-109 of the 2022 board paper package.

where the creditor government (or an agency acting on its behalf) maintains continuous and full ownership of the entire bond series.[27] The Fund would rely in the first instance on the creditor's representation of continuous and full ownership. The Fund could challenge that representation but would give the creditor the benefit of any reasonable doubt.

36. Direct Bilateral Claims are split, for Fund policy purposes, into two categories. The categorization reflects whether a debt restructuring was needed in a Fund-supported program in which the arrears existed. In economic terms the categorization reflects whether the member has the ability to clear the arrears without any debt relief (which requires the resources to do so and that such payments not affect CoT commitments to other creditors).[28]

- **Official Sector Involvement (OSI)-related.** A claim is considered OSI-related in two instances. First, a claim is OSI-related when it is covered by a past official-sector restructuring—that is when a previous restructuring (through Paris Club, CF, or outside such processes) covered the underlying claim. Second, a claim is OSI-related when a debt restructuring, including participation from official bilateral creditors, is required under the current program parameters to ensure that the program is fully financed, debt is sustainable, and the Fund's resources are adequately safeguarded. Note that an "OSI-related" classification holds even if the debtor member's situation has improved to the point that it could now pay the claim in full.[29] OSI-related direct bilateral claims are subject to the Fund's Lending into Official Arrears Policy (go to Section IV.B below).

- **Non-OSI-related.** A claim is considered non-OSI-related when it is not covered by a past restructuring and the current Fund-supported program anticipates payment in full. In addition, a claim is considered non-OSI-related where it was previously restructured but creditors clawed-back treatment because of a breach of Comparability of Treatment (CoT) requirements. Note that a claim that was originally non-OSI-related may be recategorized as an OSI-related claim if required by subsequent economic developments.[30] Non-OSI-related direct bilateral claims are subject to the Fund's Non-Toleration Policy (go to Section IV.A below).

[27] For further details about various scenarios regarding claims with vote pooling, see 2022 Review at paragraphs 72-74.

[28] Whether a restructuring is needed is guided by existing Fund lending policies and debt sustainability analyses and is made by the relevant area department and SPR in consultation with other reviewing departments for approval by management and ultimately by the Board; see Section VI.

[29] The alternative approach of not carrying forward the determination would create perverse incentives: the prospect of having claims reclassified as non-OSI as the debtor's situation improves could incentivize official creditors to hold-out for eventual full repayment, free riding on the creditors who accepted a debt restructuring.

[30] For example, if a claim arose under a Fund supported program that had sufficient financing to allow for its clearance (i.e., the claim was non-OSI related) but due to adverse developments, the debtor later announced a needed debt restructuring covering the claim, the claim would be reclassified as OSI-related going forward.

Arrears to International Financial Institutions

37. For the purposes of Fund policies, IFIs are defined as financial institutions with at least two sovereign members and no non-sovereign members. For these purposes, "sovereign" means that the members are countries, government agencies (see definition in Box 1), central banks, or public entities acting on behalf of a government (see definition in paragraph 27). Institutions with private shareholders would not be considered IFIs (and their claims would instead fall under the LIA policy; go to Section IV.D below).

38. Claims of IFIs subject to Fund arrears policies are defined as: those claims that originate from a transaction where the IFI provided or guaranteed financing to the borrowing member *or* provided support in the context of a BOP crisis in the form of bond purchases in the secondary market. In the latter case, facilities or purchase programs that are set up to undertake such purchases should be considered part of the Global Financial Safety Net (GFSN). This logic generally applies only to sovereign bonds acquired under purchase programs of reserve currency union central banks (RCUCBs) or regional financing arrangements (RFAs).

39. There are important exclusions to the definition of IFI claims for Fund policy purposes (arrears on these excluded claims are subject to the Fund's LIA policy; go to Section IV.D below):

- **Certain IFI claims that do not relate to financing of a public-good nature.** Arrears on claims related to IFI financing of a global public-good nature, even outside the context of resolving BOP problems, are protected under the arrears policies, while arrears on other types of claims—such as membership fees or treasury/investment operations—are considered to fall outside the arrears policies.[31]

- **Certain bond purchases in the secondary market done for BoP support.** Where an IFI that would be considered a part of the GFSN indicates in its own public statements that it expects a claim to be treated pari-passu with privately held claims, the LIA policy would be applied to those claims.[32]

- **IFI claims that are subject to vote pooling with the private sector.** Vote pooling is assessed in the same way for IFIs as for Direct Bilateral Claims (see paragraph 35). Subjecting vote-pooled claims to the policies on IFI arrears would risk complicating restructuring processes, so such vote-pooled claims are excluded from the definition of IFI claims for the purposes of the arrears policies, even when done for BoP purposes as part of the GFSN.

[31] Most overdue membership fees are owed to multilateral non-financing institutions—and key IFIs do not impose membership fees.

[32] There are cases where an IFI indicates that it wants its own claim to be treated pari-passu with (meaning the same as) privately held claims. This has happened, for example, in some programs by RCUCBs. In such cases, the Fund would defer to the IFI and the LIA policy would apply. The IFI's most recent assertion at the time of the Fund's application of the arrears policy would apply.

40. For the purposes of applying Fund policies, IFI claims are split into two categories:

i. **Non-OSI-related.** A claim is considered non-OSI-related when it is not covered by a past restructuring and the current Fund-supported program anticipates payment in full. Such claims are subject to the Fund's Non-Toleration Policy (go to Section IV.A below).

ii. **Official Sector Involvement (OSI)-related.** A claim is considered OSI-related when it is covered by a past restructuring (i.e., when a Paris Club or CF agreement post-dates the underlying claim or when there was an announced restructuring outside the Paris Club or CF that covered the underlying claim), or when a debt restructuring including participation from official bilateral creditors is required under the current program parameters to ensure that the program is fully financed, debt is sustainable, and the Fund's resources are adequately safeguarded. Such claims are also generally subject to the Fund's Non-Toleration Policy, but may, in certain circumstances where the creditor community does not confer de facto preferred creditor status, become subject to the Fund's Lending into Official Arrears Policy.

41. When claims are OSI-related, then for the purpose of applying Fund policies the de facto preferred creditor status of the IFI must be determined. The Fund's arrears policies for IFIs are intended to reflect the *de facto* special treatment they generally receive by being excluded from the scope of debt restructurings by the creditor community. It is important to emphasize that de facto preferred creditor status is granted by the official creditor community, not by IMF policies (whose design is a reflection of the former). There are two cases to consider:

- **IFI claims not likely to be restructured.** Here the Fund's non-toleration policy (NTP) applies (go to Section IV.A below). In this context:
  - The NTP will always apply to arrears to the World Bank Group and will generally apply to arrears to other IFIs.[33]
  - More generally, IFIs with broader/global membership (i.e., 50 percent or more of Fund's total voting power) have been excluded from restructurings historically, and it is expected that IFIs with global membership will almost surely benefit from application of the NTP, and staff must assume that is the case (unless Fund members explicitly indicate to staff that the Board will not apply the NTP to such IFI).[34]
  - It is expected that RFAs and RCUCBs will almost always benefit from the application of the NTP, and staff must assume that is the case (unless Fund members explicitly indicate to staff that the Board will not apply the NTP to such IFI).

[33] The World Bank Group benefits from special treatment under the Bank-Fund Concordat. IMF-World Bank Concordat, 1989.

[34] See 2022 Review in Table 3 for the membership of various IFIs.

- **IFI claims possibly falling within the perimeter of a restructuring.** The Fund's Executive Board may decide to apply the LIOA to OSI-related IFI claims if the weight of the following factors suggests that official creditors expect the IFI's claims to be restructured (if so, go to Section IV.C below). The judgment as to whether the NTP applies to an IFI is case-specific, and the treatment of any IFI may differ across cases if the weight of the factors shifts:
  - *The IFI has regional membership.* This should be understood to mean less than 50 percent or more of Fund's total voting power.
  - *The institution is not an RFA or RCUCB forming part of the GFSN.*[35]
  - *The institution is inside the scope of a debt restructuring by the Paris Club or CF (including a Paris Club member).* To the extent possible, the treatment of the claims under the Fund's arrears policies should be consistent with the treatment the claims are likely to receive in the PC. In order to understand the creditor committee's intentions, early consultation with the secretariat is critical.
  - *The Paris Club has included the institution's claims in the scope of past restructurings*. This criterion can generally provide an early working assumption where the treatment of the IFI in the *current* case has not yet been decided by official bilateral creditors in a representative standing forum.
  - *The institution did not participate as a multilateral creditor in the HIPC Initiative*. This criterion would not be applicable to IFIs that were established after the HIPC Initiative. Moreover, given the length of time since the HIPC Initiative, this criterion is likely to be of decreasing relevance relative to more recent treatments of IFIs.
  - *The institution's claims relate to a period when it was not seen as an IFI for the purposes of Fund policies due to private shareholdings.* This avoids strategic behavior by creditors in the context of restructurings (which can be disruptive) and protects borrowers and other creditors from sudden and unanticipated ex-post shifts in the creditor seniority structure.

Arrears to Non-Sovereign Creditors

42. Arrears on claims owed to non-sovereign creditors include those owed by sovereign debtors to private external creditors and to public-sector entities that are not part of the budgetary process of the government in the creditor country or acting on behalf of the creditor country

[35] RFAs are defined as a "finance mechanism backed by pooled resources through which a group of countries pledge common financial support to a fellow member in the event of external liquidity needs for balance of payment (BoP) difficulties." See Collaboration Between Regional Financing Arrangements and the IMF, July 2017, at p. 6. While the list of RFAs is open to new entrants it would currently include: the Arab Monetary Fund (AMF), BRICS Contingent Reserve Arrangement, Chiang Mai Initiative Multilateralization (CMIM), Eurasian Fund for Stabilization and Development, EU-BOP Facility, European Stability Mechanism (ESM), European Financial Stability Mechanism, and the Latin American Reserve Fund.

government. They also include claims owed to multilateral institutions with one or more private sector shareholders. Such arrears are subject to the LIA policy (go to Section IV.D below).

43. With respect to arrears owed to non-sovereign creditors, only those on underlying *debt obligations* are subject to the Fund's arrears policies. Unlike for official bilateral claims, where the arrears policies cover all underlying obligations, the arrears policies cover only obligations to non-sovereign creditors arising from commercial financial obligations of a contractual nature that are not paid when due (taking into account any contractual grace periods).

- In making a determination of whether an obligation is "debt," the Fund shall make an assessment based on the characteristics of the obligation—especially whether it includes a deferral of payment—and the language used in a contract to describe the arrangement would not necessarily be conclusive. Reference can be made to the definition of "debt" in the Debt Limits Policy.[36] Staff should consult SPR and LEG as needed.
- Thus, included are arrears on: bank loans, suppliers' credits (i.e., where the creditor contractually defers payment, or the good/service does not need to be paid on delivery), and bonds.[37]
- Not included are arrears on non-debt obligations, such as financial obligations originating from an arbitral award on an underlying non-debt claim, unpaid dues, payment on delivery, power purchase agreements,[38] or obligations to acquire assets. Note that such other obligations can nonetheless have implications for the Fund's fiscal and debt sustainability analyses, as well as debt-related conditionality on accumulation of new arrears in cases where their definition for program purposes includes such obligations.

Jurisdictional Arrears (Private-to-Private Arrears Arising Due to Exchange Restrictions)

44. Jurisdictional arrears refer to arrears *on debt service* by *non-sovereign borrowers* that arise because of the imposition of exchange controls. In other words, exchange restrictions imposed by sovereign members may cause private-sector residents of that member to be unable to obtain foreign exchange to pay debt service on time to non-resident private creditors.[39] Such arrears now

[36] The term "debt" is understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract.

[37] See Reviews of the Fund's Sovereign Arrears Policies and Perimeter, May 2022, Annex III.

[38] Under the typical power purchase agreement, state-owned electricity companies are required to regularly pay a certain amount to an independent power producer to ensure access to power. Because these payments are contingent on the power producer demonstrating a capacity to produce a certain amount of power, and the payment is not deferred, they are more akin to payment-on-delivery than debt obligations. However, if there is an agreement to convert missed payments into debt, then the arrears policy would apply to missed payments on that debt.

[39] Exchange restrictions are exchange measures identified by LEG, in consultation with staff in the Monetary and Capital Markets Department, as being subject to the Fund's jurisdiction under Article VIII, Section 2(a) of the Fund's Articles of Agreement. Please consult LEG closely on any application of this strand of the arrears policy, which must align with exchange restriction findings.

constitute only a small subset of cases—staff identified three such cases since 2002.[40] These arrears fall under an element of the Fund's LIA policy (go to Section IV.D).

Staff Report Requirements

45. Staff report requirements include:

- The staff report should identify the type of each claim in arrears and the arrears policy that applies to each claim in arrears. Where there is judgment involved—e.g., in determining whether a claim is a Direct Bilateral Claim, whether an entity is an IFI, or which policy should apply to an IFI claim—staff should provide the Board the information necessary for the Board to make its judgment. Additional details will be especially important should staff recommend applying the arrears policies in a manner that would differ from precedents—e.g., where the weight of factors suggests applying the LIOA to IFI claims given NTP treatment in other restructuring cases.
- Appendix III provides details on how to record *OSI-related* arrears in the DSA; the program should assume that *non-OSI-related* arrears will be cleared in the near-term.

APPLYING THE ARREARS POLICIES

46. This section covers the application of the Fund's arrears policies. Once a determination has been made about what type of arrear exists and the policy which is relevant (previous section), then that policy must be applied. This section discusses the non-toleration policy (NTP), the lending into official arrears policy (LIOA) (which has four strands, covering different circumstances that can arise), the LIOA policy as applied to IFI arrears, the lending into arrears policy (LIA), the LIA policy as applied to jurisdictional arrears, and the special considerations that arise in applying the policies in emergency financing situations.

47. The application of the arrears policies generally provides the Fund with adequate safeguards. In establishing the arrears policies, the Fund has determined that the application of the relevant policy, along with the completion of financing assurances reviews, generally provides such safeguards. This is because the policies are designed to encourage the resolution of arrears in line with the restoration of debt sustainability and in line with the program's available financing space.

48. It is important to note at the outset that where payments are in arrears due to factors outside the debtor's control, such as international sanctions, the arrears policies are generally considered met when payments are made into escrow.[41] This will typically apply to arrears to official bilateral creditors under sanctions. While the details of the escrow arrangements will be country-specific, ultimately the Fund should be satisfied that the escrow arrangements ensure that

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[40] Iceland 2008 (IMF Country Report No. 08/362); Latvia 2008 (IMF Country Report No. 09/3); São Tomé and Príncipe 2019 (IMF Country Report No. 19/315).

[41] This approach has been taken in cases where arrears have accumulated to official bilateral creditors due to sanctions or the lack of a counterpart on the creditor side (e.g., Bangladesh, 2023; Georgia, 2022; Moldova, 2022; Mali, 2013; Honduras, 2011).

the amounts being set aside shall not be used for purposes other than the debt service in question.[42] In order to satisfy the arrears policies, payments into escrow should be for the full amount due and made on the contractual due date, taking into account any contractual grace period. Note that payments into escrow will not address compliance with the external arrears performance criterion unless the TMU definition specifically permits.

A. Non-Toleration Policy

49. This section addresses the application of the NTP in three situations in turn. To understand how to determine that these situations apply, see the discussion in Section III. Note that the NTP has a broader scope of application than the LIA or LIOA. Arrears on a non-debt claim held by official creditors are subject to the NTP in a non-OSI context, even where the underlying claim is not an extension of financing.[43] Note also that no financing assurances review is required for any of these cases.

50. The NTP is applied as follows:

- **Where arrears are owed to the World Bank Group.** The Fund requires, in line with the terms of the 1989 IMF-World Bank Concordat, either: (i) upfront clearance of the arrears before approval of the Fund-supported program or completion of a review under the program; or (ii) an agreed plan between the member and the World Bank on terms of clearance over a defined period.[44] Where arrears have arisen to the World Bank Group, country teams should proactively reach out to World Bank counterparts to discuss progress toward resolution and confirm the presence of an agreed plan for the clearance of the arrears.
- **Where arrears are owed to other IFIs.** The NTP requires that the debtor have a credible plan and projected financing to eliminate arrears over the program period. Such a plan must be credible to Fund staff—and ultimately the Executive Board—but the creditor's concurrence is not required. In the context of legacy arrears covered by MDRI, an IFI's broader commitment to that initiative can form the basis for staff's assessment of a credible plan for resolution in line with the program parameters at the time of HIPC.
- **Arrears on Non-OSI claims held by official bilateral creditors.** The NTP requires the tacit approval of the creditor to Fund financing despite the arrears. This is generally conveyed by the non-objection of the creditor's Executive Director at the Board meeting. However, to ensure the policy will be met, Area Department staff should reach out to creditor Executive Directors in advance to ensure there will be no objection. Where an Executive Director signals that a creditor

[42] Escrow accounts would normally be held by a third party (which may include an independent central bank) under irrevocable instructions to pay out to the creditor once certain conditions are met (e.g., sanctions are lifted). However, in certain country circumstances, a reputable third-party agent may not be available (e.g., due to a lack of central bank independence or reputable commercial banking relationships), in which case alternative arrangements—such as a separate account in the central bank—may be required, and staff will need to be satisfied that such arrangements are functionally equivalent given the country circumstances.

[43] For treatment in an OSI context, please consult with SPR and LEG.

[44] IMF-World Bank Concordat, 1989.

will object, the policy will not be met, and the staff report cannot be issued to the Board until the arrears to that creditor are either cleared or until the creditor changes its mind.

51. Staff report requirements:

- For World Bank arrears, Staff reports should identify any arrears remaining at the time of issuance of the staff report to the Board and provide details of the agreed plan for their resolution. For LICs, the DSA, as a joint Bank-Fund document, would generally be a good place to report the agreed plan.
- For other IFI arrears, the staff report should record the fact of the arrears and the plan for arrears clearance, and this should be reflected in the program and DSA assumptions.
- For arrears on non-OSI Direct Bilateral Claims, even though the tacit approval should not be recorded in the staff report, the arrears would need to be reported. For program financing purposes (including for the DSA), it should be assumed that these non-OSI arrears will be cleared in the near-term (i.e., normally within 6-12 months), and the determination as to whether the program is fully financed should be made on this basis.

B. Lending Into Official Arrears as Applied to Direct Bilateral Claims

52. The LIOA policy applies to OSI-related Direct Bilateral Claims. See Section III.B above for information on how to determine that a direct bilateral claim exists. The LIOA policy may be satisfied in four ways, each of which is discussed below. Where the debtor is requesting emergency financing (under the RCF or the RFI), the policy allows for flexibility in exceptional circumstances, described in section F below.

Strand 1: Representative Standing Forum

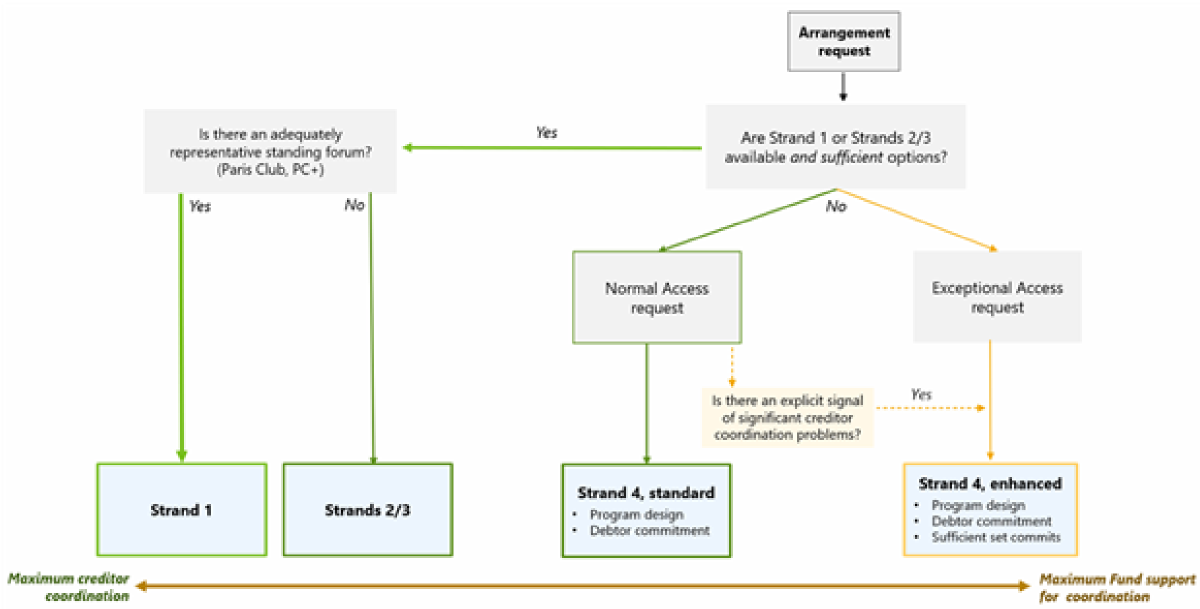
53. The first—and preferred—way the LIOA policy may be satisfied is through an "adequately representative" restructuring agreement by a representative standing forum. Such an agreement is reached when financing assurances are received from the representative standing forum in anticipation of the restructuring agreement (e.g., the Agreed Minute for the Paris Club or Memorandum of Understanding (MOU) from an Official Creditor Committee (OCC) including Paris Club under the CF).[45,46] Where such an agreement is reached, all arrears arising on

[45] The Paris Club or CF creditors set a "cut-off date" that generally excludes credits extended after that date from the debt treatment. Arrears related to post-cut-off date debt that are not covered by the agreement need to be cleared. If the debtor is unable to remain current on post cut-off date debt, that would be an indication that its balance of payment problems have not been resolved.

[46] As discussed in Section II.B, an agreement is considered reached when there is a preliminary indication that the Paris Club is willing to provide debt relief in anticipation of an Agreed Minute. That assurance is derived verbally during the Paris Club meeting where the treatment is discussed. For treatments under the Common Framework involving a Paris Club member, the assurances can also be derived in a similar verbal fashion. Following approval of an arrangement by the Fund, there will be further Paris Club or Common Framework Official Creditor Committee meetings to reach an Agreement in Principle, which would then be codified in the Agreed Minute or MOU, and which will then guide the bilaterally agreed treatments that provide the actual debt relief. Note, in the past, only one further meeting of the Paris Club was generally required to reach the Agreed Minute.

pre-cut-off date debt would be considered eliminated for purposes of the LIOA policy for both participating and non-participating creditors.

Figure 3. Determining Which Strand of the LIOA to Apply



Source: [Policy Reform Proposals To Promote The Fund's Capacity To Support Countries Undertaking Debt Restructuring](), April 2024.

- However, if a bilateral agreement is not concluded with a creditor by the deadline set forth in the forum's restructuring agreement (i.e., the Agreed Minute or MOU), the arrears to that creditor would be judged to arise anew for the purposes of this policy unless the Fund judges that the debtor is making "best efforts."[47,48] If staff cannot support a judgment that the debtor is making "best efforts" at any request for Fund financing or review, the approval of the

[47] Agreed Minutes or MOUs are not legally binding and require each creditor to reach a separate, bilateral and legally binding agreement implementing the terms of the Agreed Minute or the MOU with the debtor by a deadline set forth in the Agreed Minute.

[48] "Best efforts" are determined on a case-by-case basis but would generally require the debtor to reach out to the creditor periodically—typically at every review, though, where a creditor has been consistently non-responsive, less frequent contact may be sufficient—in writing to explain the terms required by the Paris Club Agreed Minute and offer to discuss terms within those parameters. In the case of longstanding legacy arrears (over 5 years), one final written communication from the debtor reiterating its willingness to restructure under the Paris Club Agreed Minute terms would suffice to meet the requirement going forward until the creditor is willing to accept such terms. If the discussions advance, the debtor should confirm with the Paris Club Secretariat whether an offer is consistent with the Paris Club Agreement Minute; Fund staff cannot advise. The debtor would also be expected to respond to any inquiries or correspondence from the creditor. Please note that "best efforts" and "good faith efforts" are different concepts; the latter is explained in detail in paragraphs 75-81, below. Refer to Appendix VII for suggested language in policy notes and staff reports. In practice, staff would need to be able to support its assessment that "best efforts" are continuing at each review if asked, even if not explicitly reported.

arrangement or the completion of the review may only proceed where consent is received from the creditor(s).[49]

54. An "adequately representative agreement" provides a majority of total financing contributions required from official bilateral creditors over the program period (share > 50 percent). For the purposes of this policy, "contributions" are limited to debt relief and any form of new financing (such as loans, bond financing, guarantees and grants) that directly help meet the program's financing and/or debt sustainability targets. To calculate the majority share, country teams must obtain in advance data on: (i) official bilateral debt service falling due during the program period; and (ii) new financing provided/committed by official bilateral creditors during the program period (as reflected in the BOP projections). Representativeness of the agreement by the standing forum would be assessed as the ratio of expected financing contributions by standing forum creditors relative to total financing required from all official bilateral creditors. Financing contributions comprise debt relief and new financing. Appendix VI illustrates the required data and calculations with a simple numerical example. Given the importance of these calculations for the application of the policy, country teams are encouraged to liaise with SPR at an early stage to ensure that the above calculation is done properly.

55. Only the Paris Club or CF with Paris Club participation is considered a "representative standing forum" for the purposes of the LIOA policy as of 2024. This treatment arises from the Paris Club's long-standing coordination function, the close coordination between the Paris Club secretariat and Fund staff, and the Paris Club's track record of support for Fund arrangements.

56. Staff report requirements. The staff report should note that the agreement is adequately representative and that, on this basis, the arrears including to nonparticipating official bilateral creditors can be considered eliminated for the purposes of the LIOA policy. The staff report should also add the "best efforts" assessment whenever required. Refer to Appendix VII for suggested language in policy notes and staff reports. For new applications of Strand 1 after the April 9, 2024, adoption of the relevant policy change, a financing assurances review would be required at each review until the bilateral agreements are signed.[50] Appendix III describes how arrears should be reported in the DSA when the LIOA is applied.

[49] In these cases, there is no prospect of satisfying the "good faith effort" criterion, meaning the only way forward for Fund financing in these cases is creditor consent.

[50] See Policy Reform Proposals to Promote the Fund's Capacity to Support Countries Undertaking Debt Restructuring, April 2024.

Strand 2: Consent

57. If an adequately representative agreement from a representative standing forum is not available, then the LIOA policy may be satisfied where the creditor(s) provide consent to Fund financing despite the arrears. Such consent does not cover an agreement or commitment to resolve arrears. The Fund should continue to encourage the parties to reach an agreement during the period of the arrangement, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financing system at large. Where a majority of creditors have not yet restructured, additional safeguards will typically be desired by creditors to ensure adequate creditor coordination, preventing consent. Application of the Strand 4 of the LIOA (discussed later in this section) is then required.

58. Consent may theoretically be provided or withdrawn at any time. Withdrawal of consent leading up to a Board meeting has not previously happened.[51] In the event that consent is withdrawn, Fund management cannot recommend Board approval of an arrangement or completion of a review unless one of the other LIOA strands is satisfied. Executive Directors representing creditors to which arrears are owed may still object on their authorities' behalf at any time (including at the Board meeting) to Fund financing. In that case, there would be two routes forward:

- Staff would need to be prepared to demonstrate that the three criteria (Strand 3) are satisfied in order to allow approval of the arrangement request or completion of the review, notwithstanding the arrears.
- For any creditor to whom the three criteria cannot be applied, failure to provide consent (or withdrawal of consent) re-routes the LIOA to Strand 4.

Clear communication with creditors' Executive Directors in advance of the Board meeting and recording of consent in the staff report for transparency purposes should mitigate any risks and discourage last-minute changes in creditors' positions.

59. For operational reasons, staff must take a proactive role, reflected in requirements for the staff report:

- *Timing of consent.* Consent should generally be received before the staff report is issued to the Board and be recorded explicitly in the staff report.[52] This is necessary because staff needs to know whether or not to assess the three criteria under Strand 3 (next section), and the Board would need time to consider that assessment.[53] In cases where the concerned creditor requests more time to consider providing consent, the staff report should only be issued to the Board in

[51] There have been cases where consent was provided at arrangement approval but not at the time of later reviews, e.g., from Libya in Central African Republic's 2016 arrangement under the ECF.

[52] This differs from tacit consent, which is applicable only in non-OSI cases where the NTP applies (see paragraph 50).

[53] Application of the Fund's Policy on Arrears to Official Bilateral Creditors—Modalities of Creditor Consent, April 2017, FO/DIS/17/46.

cases where staff has determined that the three criteria are met (if the criteria are not met and consent has not been received, management cannot recommend the approval of the request for Fund financing). The staff report can be circulated to the Board, but it should state that the creditor has requested more time and indicate that a staff statement on the creditor's position will be issued one week ahead of the Board meeting. To encourage consent, the analysis of the three criteria should not be included in the staff report while staff is awaiting it. Staff would need to follow up with a staff supplement one week prior to the Board meeting to clarify whether consent has been received, and if not, set out the assessment of the three criteria.[54]

- *Typical modality of consent*. The area department should reach out to the relevant Executive Director(s) while preparing the staff report (or earlier) to secure the creditor's explicit consent. Creditor consent is generally conveyed to staff through the creditor's Executive Director but may be conveyed directly from the authorities. In the latter case, the Executive Director should be informed. Consent does not need to be conveyed in writing, but written consent may allow the area department to maintain a clearer record.[55]

- *"Deemed consent" where creditor authorities cannot be reached.* In cases where the Executive Director representing the creditor country authorities reports difficulties or delays in securing explicit consent in a timely fashion, a streamlined approach is available.[56, 57] The country team should contact the relevant creditor country Executive Director(s) during the staff report preparation stage (or earlier) at every review and request consent to be received no later than one week before the expected date of circulation of the staff report to the Board. The Executive Director(s) would be informed that anything other than an objection (including no response by this deadline) would indicate consent and that this "deemed consent" would be noted in the staff report that is subsequently issued to the Board.[58]

Strand 3: Application of the Three Criteria

60. If neither an adequately representative agreement nor creditor consent is available, then the LIOA policy may be satisfied through application of the LIOA's "Three Criteria". These

[54] Previous examples include: Grenada (Country Report No. 2020/161, supplementary information, Annex I); The Gambia (IMF Country Report No. 2020/102, Annex II); Central African Republic (IMF Country Report No. 2019/216, supplementary information, Annex I).

[55] In the case of oral consent, it would be advisable for the area department to create a written record—for example by sending an email to the Executive Director noting that the consent was provided.

[56] "Deemed consent" is not appropriate where creditor authorities can be reached but request additional time to consider providing consent. Subparagraph (a) describes the applicable process for such cases.

[57] Application of the Fund's Policy on Arrears to Official Bilateral Creditors—Modalities of Creditor Consent, April 2017, FO/DIS/17/46.

[58] Previous examples include: Central African Republic (Country Report No. 2018/214, footnote 2); Central African Republic (Country Report No. 2017/407, footnote 1); Central African Republic (Country Report No. 2017/245, footnote 3).

are discussed below, in turn. The final decision to provide financing will be made by the Board, based on staff's assessment.

- *Criterion 1: Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies.* Where prompt support is not required, the member should be encouraged to resolve its arrears prior to seeking Fund financing.

- *Criterion 2: The debtor is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution.*

- *Criterion 3: The decision to provide financing despite the arrears would not have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases.*

61. Criterion 1 will be satisfied by construction in the case of a disbursing Fund arrangement. This requirement is not applicable when the policy is applied by analogy to non-financing arrangements, such as the Policy Coordination Instrument.

62. In assessing whether a debtor is acting in good faith (Criterion 2), the Fund will consider the following elements relating to *process* and *terms offered* by the debtor:

- ***Process:*** Broadly analogous to the private-creditor context, the Fund would consider, *inter alia*, whether the debtor:

    - has approached the creditor to which it owes arrears either bilaterally or through a relevant grouping of official bilateral creditors, recognizing that the latter may take several forms, including *ad hoc* creditor committees;

    - has offered to engage in substantive dialogue with the creditor and has sought a collaborative process with the creditor to reach agreement; and

    - has provided the creditor relevant information on a timely basis.[59]

- ***Terms offered****:* The Fund would consider whether terms offered to official bilateral creditors:

    - are consistent with the parameters of the Fund-supported program (requesting terms that would result in financing contributions from the official bilateral creditor that exceeded the requirements of the program would generally not indicate good faith on behalf of the debtor); and

[59] "Relevant information" would generally include (i) the exchange of current macroeconomic and debt data, (ii) disclosure of the proposed treatment for different creditor classes, and (iii) transparency around macro policy assumptions (to the extent such information can be disclosed). See Reviews of the Fund's Sovereign Arrears Policies and Perimeter and Appendix VIII on sharing information underlying DSAs with creditors.

- do not imply a contribution that is "disproportionate" relative to other official bilateral creditors.

  - There are several, possibly complementary, ways to assess the burden-sharing implications from the terms offered, including the relative size of the nominal contributions ("nominal shares"), relative size of contributions in net present value (NPV) terms ("NPV shares"), and the difference between the nominal share and the share in total debt service falling due ("net financing shares"). Table [xx] illustrates these calculations with a numerical example. In the event that such measures yield different results staff would need to determine which are the most relevant, taking into account the specifics of the case. Note that this is the only instance where staff must explicitly assess comparability of treatment among creditors.

63. In assessing Criterion 3, the Fund will consider the signal that such a decision would send to official bilateral creditors as a group, given the specific circumstances of the case. In assessing this criterion, staff would need to consider:

- *Size of contributions:* The criterion would normally not be satisfied where it is being applied to an official creditor or group of creditors accounting for the majority of total financing contributions required from official bilateral creditors over the program period.[60] Staff should thus provide a breakdown in the staff report of the relative shares of contributions by creditors to whom the three criteria are being applied.

- *Track record:* The assessment would also consider the creditor's track record of providing contributions in past debt restructurings under Fund-supported programs. This is one factor to consider but is not determinative, in particular if the creditor has signaled non-cooperation in a forward-looking sense. Where available, staff should provide a brief description of the creditor's overall track record of participation in the five most recent debt restructurings under Fund-supported programs in which the creditor held claims, and discuss expectations for future restructuring cooperation, if relevant.[61]

- *Other considerations:* In practice, the Fund has also taken account of case-specific factors that mitigate risks for mobilizing financing (e.g., any dynamics specific to the debtor and creditor that would create specific incentives that would not affect other cases, such as the application of the arrears policy in Ukraine's 2015-18 extended arrangement).

[60] Deviations from this rule will be "abnormal" and "should be in line with the Fund's mandate and based exclusively on a determination as to whether the Fund's decision to provide financing despite the arrears would have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases" Summing Up on Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors, December 2015.

[61] If data are readily available, staff may consider a larger set. Information on past financing contributions under Fund-supported programs could be found, for instance, on the Paris Club website (http://www.clubdeparis.org/en/) and the latest statistical updated for the HIPC and MDRI Initiatives (www.imf.org/external/np/pp/eng/2016/031516.pdf).

64. Staff report requirements. Staff's assessment of each criterion must appear in the staff report the first time it is conducted; subsequent assessments may cross-reference earlier staff reports for the details but must still assess that the criteria are met.[62] Refer to Appendix VII for suggested language in policy notes and staff reports.

Strand 4: Application of Additional Safeguards

65. Application of Strand 4 requires a determination that Strands 1-3 cannot be satisfied. Staff should go about this determination as follows:

- Staff should always start by determining whether Strand 1 is available via communication with the secretariat of the applicable "representative standing forum" and by calculating whether the creditors involved could generate an adequately representative agreement (see paragraph 54 above).
- In the event Strand 1 is not available:
    - Regarding Strand 2, staff should ask as early as possible for consent. If consent is not forthcoming from any creditor to whom Strand 3 cannot be applied within four weeks after a staff's request to that creditor, then Strand 2 is considered to be unavailable. Staff may choose to extend this deadline, if deemed useful (i.e., if there are indications that consent may be forthcoming).
    - Staff can assess Strand 3 per the section above.
    - Note that the assessment of which strand should be used is not necessarily static over the course of an entire program. For example, in the event that Strand 1 becomes available before a Board meeting, then the approach would revert to Strand 1 (but all existing agreements on safeguards, per the discussion that follows, would remain in place). Further, if additional safeguards are warranted as the program progresses, as dictated by the requirements of the financing assurances review, a case may move from Strand 1 to Strand 4 (Standard Safeguards) and from there to Strand 4 (Enhanced Safeguards).
    - In the event that Strand 2 and/or 3 are available but the request is for exceptional access, then Strand 4 should be used.

66. Once staff assesses that Strand 4 applies, then a determination must be made on which safeguards approach to apply:

- **The Standard Safeguards Approach**. This is the default Strand 4 approach for normal access cases. However, this approach would not apply where: (i) there is an explicit request from any

[62] Previous examples include: Ukraine (IMF Country Report No. 16/319, Box 4); Grenada (Country Report No. 2020/161, supplementary information, Annex I); The Gambia (IMF Country Report No. 2020/102, Annex II); Central African Republic (IMF Country Report No. 2019/216, supplementary information, Annex I).

representative standing forum, or any other creditor to whom the three criteria could not be applied, for additional Fund support to facilitate creditor coordination efforts; or (ii) a representative standing forum or any other creditor to whom the three criteria could not be applied signals that it has no intention to restructure in line with program parameters.[63]

- **The Enhanced Safeguards Approach.** This approach is applicable to all exceptional access (GRA or PRGT) or high combined access (GRA+PRGT) to Fund financing to which the LIOA policy applies that do not fall under Strand 1. It also covers normal access cases where one or both of the two exclusions noted in the first bullet apply.

67. When applying the Standard Safeguards Approach, staff should utilize a combination of program design elements and debtor commitments to establish safeguards:

- **Capped initial access.** In order to address safeguards risks to the Fund, a case applying Standard Safeguards Approach will only proceed where the initial disbursement or purchase (upon arrangement approval) does not exceed the annual access limits under the regular window of the Fund's emergency financing instruments. Because phasing should be aligned with the member's BOP needs and policies, the pace of implementation of adjustment measures would need to be adjusted accordingly.

- **Program conditionality.** To provide additional safeguards, staff should consider conditionality. In line with the Guidelines on Conditionality, program conditionality should only be proposed where the measures are reasonably within the member's direct or indirect control and are of critical importance for achieving the goals of the member's program or for monitoring the implementation of the program.[64] In the circumstances where Strand 4 apply, these standards would generally be met, and conditionality would be particularly well justified in the absence of other mechanisms to ensure a successful restructuring. There are two relevant types (see Section VI.D for further discussion):

    - **Structural conditionality.** This can cover issues such as debt transparency, information sharing, or milestones in the process within the control of the authorities. The focus should be on measures that can help keep a restructuring process on track. Such measures should be discussed with the debtor's legal and financial advisors to ensure they are aligned with the envisaged timeline and strategy. To date, restructuring-related Fund conditionality has generally focused on privately held debt (see Appendix XI). However, similar measures could be adapted to the official sector. Conditionality should not be set on measures outside the

[63] Note that a failure to provide consent (or even an objection) to Fund financing despite arrears (strand 2) is not equivalent to indicating that the creditor will not restructure its claims in line with program parameters.

[64] Guidelines on Conditionality, September 2002, paragraph 7(a). Conditionality may also be proposed where necessary for the implementation of specific provisions of the Articles or policies adopted under them. For further information on designing conditionality, see Operational Guidance Note On Program Design and Conditionality, January 2024.

debtor's control, such as reaching agreement on the restructuring, though the authorities may make commitments of their intentions in the letter of intent or MEFP.[65]

- **Quantitative conditionality.** This would generally involve standard program targets on net international reserves and fiscal targets. The focus should be on ensuring that any payments to creditors are in line with program parameters. Where a debtor has defaulted on most or all creditors, comprehensive conditionality with full coverage of below-the-line public sector accounts would strengthen the debtor's ability to ensure comparable treatment among creditors. Quantitative targets would be set under the assumption that the debtor would continue to run arrears or settle arrears on terms consistent with program parameters. Such conditionality should be discussed with the debtor's legal and financial advisors to ensure staff understands the full structure of debt and debt service.

- **Debtor commitment to good-faith efforts.** A case applying Standard Safeguards Approach will only proceed where the debtor has made a commitment to pursue good-faith efforts to reach agreement with official bilateral creditors. "Good faith" would be defined as it is under LIOA Strand 3, considering both process and terms offered (paragraph 62). This should generally be in the form of a letter to creditors, but in all cases, the MEFP/LOI should reflect the debtor authorities' commitment.

68. The Enhanced Safeguards Approach should include:

- **The conditionality and debtor commitment elements of the Standard Safeguards Approach** (the capped initial access would be dropped).

- **A direct commitment to the Fund by a "sufficient set" of creditors about their restructuring intentions**—i.e., that they intend to restructure the claims in line with program parameters. See paragraph 18 above for the definition of a "sufficient set". Once such a commitment has been received, arrears to other official bilateral creditors would be deemed away for the purposes of the Fund's arrears policies. The commitment would be in the form of financing assurances, as described in paragraphs 15-17—i.e., that a key stage in the COCP has been reached, or specific and credible assurances where a COCP assessment cannot be made. Per the definition of a sufficient set, such commitments must involve any representative creditor forum if applicable *and* any creditors with influence over the debtor.

69. Staff report requirements. The policy note should provide an explanation of why Strand 4 applies and a preliminary description of the proposed safeguards. The Staff report should explain:

- Why Strand 4 was invoked, noting why Strands 1-3 could not be applied.

[65] Regardless of whether it is part of conditionality, reaching agreement on the restructuring will ultimately be a necessary condition to ensure that debt sustainability is restored.

- Why the Enhanced Safeguards Approach applied to normal access cases, where relevant. This would involve a transparent accounting of the creditor forum or creditor that requested greater Fund support for creditor coordination efforts, or which signaled an unwillingness to restructure.

- For the Standard Safeguards Approach, staff reports should document the set of safeguards deployed and the rationale for any conditionality proposed (in line with the Guidelines on Conditionality).

- For the Enhanced Safeguards Approach, beyond documenting the debtor commitment and conditionality proposed, staff reports should explain, for each creditor in the sufficient set, the basis for the COCP assessment (or specific and credible assurances where COCP is not available) (see Section II.B).

- Where changing circumstances warrant an increase in safeguards over the course of a program, in line with financing assurances reviews requirements, the staff report should explain what the circumstances are and how the proposed measures provide the requisite safeguards.

C. Lending Into Official Arrears as applied to IFIs

70. The LIOA policy as applied to IFIs follows the same general contours as described in Section B for Direct Bilateral Claims, with some minor adjustments. As discussed in paragraph 41 above, the Fund would generally apply the NTP absent an indication from the creditor community that the claim would be within the scope of the current debt restructuring. The policy would be applied as follows:

- **Strand 1.** In the event the creditor community places the claim within the scope of restructuring, creditors will likely be acting as a coordinated group, meaning that the situation will almost certainly be a Strand 1 application. If there is an adequately representative agreement, then arrears to such an IFI can be "deemed away". When assessing whether an agreement from a representative standing forum is "adequately representative", staff should not take into account debt relief or new financing provided by the IFI.

- **Strand 2.** In the absence of an adequately representative agreement, the Fund may provide financing despite arrears to an IFI where consent has been provided by the IFI. Consent from the IFI to Fund financing despite the arrears could be conveyed directly from staff of the IFI with the authority to do so to Fund staff or via an Executive Director designated by the IFI. The timing of consent and ability to withdraw consent are described in paragraphs 58 and 59. "Deemed consent" does not apply to IFIs.

- **Strand 3.** In the absence of an adequately representative agreement or creditor consent, the Fund may provide financing despite arrears if the three criteria under the LIOA policy are met, with appropriate adaptations to the technical calculations.

- **Strand 4.** If Strands 1-3 cannot be applied to an IFI with claims inside the scope of the restructuring, or if the case involves exceptional access to Fund financing, then Strand 4 applies. The IFI should be requested to provide consent within four weeks, like official bilateral creditors. The IFI is subject to a COCP assessment or to a specific and credible assurance if the application is diverted to the Enhanced Safeguards Approach.

71. Staff Report requirements. The staff report should identify which strand of the LIOA policy will apply to the claims and why. The staff report requirements will echo those applicable to official bilateral creditors under the relevant strand, see paragraphs 56 (Strand 1), 59 (Strand 2), 64 (Strand 3), and 69 (Strand 4).

D. Lending Into Arrears Policy

Restructuring Situations

72. The LIA policy applies at each request for Fund financing (including reviews) while arrears remain outstanding. A Fund program may proceed, notwithstanding arrears subject to the LIA policy, if the LIA criteria are met. As with the LIOA policy, the LIA policy applies with flexibility in exceptional circumstances where emergency financing is requested (Section F).

73. The LIA policy may be satisfied through application of its two criteria.

- *Criterion 1: Prompt financial support from the Fund is considered essential for the successful implementation of the member's adjustment program.* Where prompt support is not required, the member should be encouraged to resolve its arrears prior to seeking Fund financing.[66] This criterion will be satisfied by a disbursing Fund program.

- *Criterion 2: The member is pursuing appropriate policies, and it is making a good faith effort to reach a collaborative agreement with its creditors.*

74. As regards criterion 2, flexibility should be used in assessing "good faith" efforts to accommodate the characteristics of each specific case. This avoids putting debtors at a disadvantage in the negotiations with creditors and can help avoid prolonged negotiations that could hamper the ability of the Fund to provide timely financing. At the same time, its application should serve primarily to support effective debtor-creditor engagement in a manner that does not impair market discipline. Typically, arrears to private creditors arise due to liquidity and/or solvency constraints requiring a debt restructuring, and the requirements of the LIA policy are geared to these cases.

75. The policy provides four principles to guide the assessment of "good faith" efforts. The LIA policy does not require specific steps be taken in all cases or mandate that all principles be

[66] This requirement is not applicable when the policy is applied by analogy to non-financing arrangements, such as the Policy Support Instrument or Policy Coordination Instrument.

satisfied in full. Rather, the policy requires staff in the first instance—and ultimately the Executive Board—to judge whether debtor-creditor discussions are proceeding in good faith based on the overarching principles provided.

Principle 1: Early Dialogue between Debtor and Creditors

76. The first principle guiding the judgment of "good faith" efforts is that the member should engage in an early dialogue with its creditors, which should continue until the restructuring is complete. The determination of whether dialogue is "early" would be case-specific but would generally be expected promptly after the announcement of a debt restructuring. As a general premise, the form of the dialogue would continue to be left to the debtor and its creditors. Typical examples include roadshows by the debtor, engagement between financial and legal advisors of the debtor and creditor, and negotiations involving both advisors and principals.

77. As part of this dialogue, in cases in which creditors have been able to form a representative committee (or committees) on a timely basis,[67] **there would be an expectation that the member would enter into negotiations with such committee(s).** A committee's representativeness would be assessed based on case-specific circumstances. However, a representative creditor committee may be expected:

- To represent a substantial portion of the principal covered by the debt restructuring. In cases where bonds contain aggregated collective action clauses (CACs), creditor committees representing a share of claims sufficient to block the activation of these CACs would typically be considered to meet this test.[68]

- To reflect the diverse financial and economic interests of the creditors whose claims are to be restructured—for example, in terms of the different instruments to be restructured, geographical location, and nature of the holders (e.g., in terms of retail and institutional investors, large and small bondholders, special purpose vehicles with control or ownership of bonds, influential financial institutions, and hold-to-maturity and distressed debt purchasers). However, no group's refusal to join the committee should act as a veto on the formation of a representative committee.

- To have the support of the creditor groups that it purports to represent. Because committees are expected to function in a purely advisory capacity under the LIA policy, the verification of claims as a precondition for negotiations has not been a serious issue, as reputational risk to the participants has generally disciplined the process. However, direct participation by the largest creditors could be encouraged. For creditor representatives, the Fund could consider whether

[67] "Timely basis" indicates that the parties should not put off engagement if there are delays in forming a creditor committee. In such cases, the debtor can consider other, less structured, modes of engagement.

[68] Aggregated thresholds for approval in enhanced CACs are 66 2/3 percent across series (in two-limb aggregated voting) or 75 percent across series for single-limb aggregated voting.

there is evidence that the participant represents the group it purports to represent, including in cases where some creditors are constrained in their ability to participate directly.

- In cases where creditors form multiple committees, some engagement with committees that individually or collectively meet the above factors would generally be warranted. Entering into detailed negotiations with multiple committees may not always be feasible, nor may it be necessary in the case of smaller, non-representative committees. In such cases, the debtor may prefer to engage with the committee that appears most representative (or if relevant, a steering group with representation from the different committees). However, where other committees hold a sizeable share of claims, debtors could still be expected to engage with those committees, including to supply relevant information at the committees' request. This would particularly be the case when there are several sizeable committees of which none is individually representative, but which are collectively representative.

Principle 2: Information Sharing between Debtor and Creditors

78. Information sharing between debtor and creditor is critical for efficient debt restructurings. Relevant information that the debtor should generally share with creditors would include a comprehensive picture of the government debt stock and its terms (in the aggregate). In this regard, debtors would generally be expected to share with their creditors: creditor composition, major subcategories of instruments (with information on the main financial terms), upcoming debt service, and collateralized debt.[69] It would be expected that aggregated debt data would include all relevant debt. To the extent that certain debt is covered by confidentiality clauses, a full breakdown may not be feasible and only the sharing of relevant aggregated data would be expected. Sharing information on a timely basis is critical, though it is recognized that data reconciliation may mean that there may be delays in sharing final numbers. See Appendix VIII for further details on the sharing of information that forms the basis of the Fund's program assumptions.

79. Staff should encourage debtor authorities to clearly communicate to its creditors the perimeter of claims subject to restructuring as early as possible. Given the many unknowns private creditors have to factor in during a debt restructuring, the sooner the debtor can specify the perimeter of claims subject to the debt restructuring (including claims held on non-government public sector entities), the sooner those creditors can make progress toward an agreement among themselves and with the debtor. Although providing this clarity is the debtor's responsibility, staff should convey the expectation that the debtor should do this at the outset of the debt restructuring process. This expectation will also help the Fund establish the requisite assurances under the LIA policy that the debt restructuring will restore debt sustainability. However, beyond establishing an *expectation* as part of the assessment of good faith, the Fund cannot (and should not) do more. The debtor should determine the perimeter of claims for a PSI and/or the terms demanded from various private creditors consistent with program parameters and objectives, and the Fund should not interfere (see Section VI).

[69] Guidance Note on Implementing the Debt Limits Policy in Fund-Supported Programs, May 2021.

Principle 3: Opportunity for Creditors to Provide Input

80. The debtor should provide creditors with the early opportunity to give input on the design of restructuring strategies and the design of individual instruments. Generally, this is done through ongoing dialogue, where creditors indicate their individual preferences, which may feed into a menu of options offered. In particular, private creditors should be encouraged to provide indicative restructuring scenarios consistent with program parameters in order to make debt resolution more efficient.

Principle 4: Terms of the Offer

81. Any terms offered to the creditors by the member should be consistent with the parameters of the Fund-supported program. While the other principles focus on procedural elements of debtor-creditor engagement, it is important to recognize that in practice, good faith engagement also depends on the financial terms of a debt restructuring proposal. In particular, "good faith" engagement would require that a debt restructuring proposal—to the extent one is made before the Executive Board meeting, which may not always be the case—be broadly in line with what is needed to restore debt sustainability, as reflected in the parameters of the Fund-supported program. In other words, the financial terms only factor into the good faith assessment to ensure that the debtor does not offer too light a restructuring that would fail to restore sustainability under the program parameters. Offering too deep a restructuring to creditors would be in line with program parameters and thus would not necessarily indicate bad faith. However, it could undermine the assessment that a restructuring will be achieved in line with program parameters.

82. Specific creditor actions or circumstances may arise, but the Fund retains flexibility to continue to provide financing provided the two LIA criteria can be assessed to be met:

- Creditors will often request terms that are inconsistent with the parameters of the Fund-supported program. Notwithstanding the lack of progress in negotiations with creditors, the two LIA criteria can be assessed as met. That would assume that the program would continue to be financed by arrears, and debt sustainability on a forward-looking basis would be achieved by the creditors eventually recognizing the necessity of a restructuring in line with the program parameters is inevitable.

- The presence of collateral can complicate application of the LIA policy. In general, the impact depends on the type and the enforceability of the collateral and whether it may undermine the assumption that arrears will finance the program and that creditors will ultimately restructure in line with the program parameters. For example, in the case of Chad (2021) where the structure of the oil sale contracts made it impossible to run arrears to its commercial creditor. In such cases, the Fund may require assurances from that commercial creditor in order to complete a financing assurances review. This is a significant risk that debtors must bear in mind when contemplating collateralized transactions.

Non-Restructuring Situations

83. Note that sovereign arrears to private creditors may arise for reasons unrelated to the need for debt restructuring, such as administrative issues on the debtor side or difficulties in effecting payments. In such cases, in practice, the standard "good faith" principles have been applied to the extent relevant as the debtor needs to engage its creditor(s) to resolve the arrears. In assessing the debtor's good faith efforts and progress to resolve the outstanding arrears, staff should account for several factors, including:

- Sufficient *frequency* in dialogue with creditors, taking into account: complexity of creditor base, previous responses of creditors, whether any logistical factors prevented the debtor from reaching out to the creditor;
- Whether the *terms* offered by the debtor or demanded by creditors are consistent with the parameters of the Fund-supported program; and
- Any case-specific factors preventing progress in the dialogue between the debtor and its creditors.

84. Staff report requirements. At the policy note stage, staff should prepare a preliminary assessment of the LIA criteria, to be verified after discussion with authorities on mission for a final determination at the staff report stage. A sample assessment for the staff report stage is set out in Box 2 and Appendix IX. In making this assessment, staff are encouraged to obtain relevant information from the debtor country authorities as well as from creditors. So long as a member has outstanding arrears to private creditors, all program reviews are also subject to financing assurances reviews (see paragraphs 19-20).

E. Lending Into Arrears Policy with Respect to Jurisdictional Arrears

85. The arrears policies can also apply in the case of jurisdictional arrears (see Section IV.E). In such cases, the LIA policy continues to help draw attention to the issue of arrears on debt-service payments arising from the imposition of exchange controls, which continue to be an important part of the Fund's mandate. The LIA policy operates in tandem with Article VIII, Section 2(a) to convey a consistent message on the need to eliminate exchange controls—and their consequent arrears—to the extent possible. The general LIA criteria are nuanced to fit the situation:

a. **Fund lending despite non-sovereign jurisdictional arrears should be on a case-by-case basis,** and only where: (i) prompt Fund support is considered essential for the successful implementation of the member's adjustment program; and (ii) the member is pursuing appropriate policies and is making a good faith effort to facilitate a collaborative agreement between private debtors and their creditors, and a good prospect exists for the removal of exchange controls.

b. **The sovereign's role in these cases differs from the case of sovereign arrears.** In the case of jurisdictional arrears, the sovereign's role is to remove the underlying exchange controls. The removal of such controls would then help resolve the non-sovereign arrears. The sovereign can also assist the resolution of the arrears by indicating how foreign exchange will be made available to service the underlying claims. In this regard, the assessment that the LIA policy is met should be supported by a description of the member's timeline for removal of the exchange controls and the anticipated availability of foreign exchange.

86. Staff report requirements. Policy notes should flag the application of the policy and prepare a preliminary assessment of the criteria. Staff reports should provide support for each criterion being met. Given the small set of cases, staff should contact SPR and LEG if they anticipate the need to apply the LIA policy due to non-sovereign arrears on debt obligations arising from the imposition of exchange controls.[70]

F. Application of the Arrears Policies (LIA and LIOA) in Emergency Situations

87. The Fund's arrears policies provide for some flexibility in their application to emergency financing cases (RCF or RFI requests). Specifically, in "*exceptional circumstances,*" financing may be provided without further procedural steps. It would be expected that the Fund's support provided to the debtor in such cases would help advance normalization of relations with the creditor(s) and resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to the arrears policies.

88. Note that even in emergency situations, the best course of action in a restructuring remains to work toward a UCT-quality program. Therefore, if an urgent BOP need does arise, it is essential that the provision of emergency financing should not undermine any broader effort underway to secure a UCT-quality program and that if a UCT program is feasible, it should be pursued.

- Emergency financing may still be appropriate even if a UCT program has been negotiated (i.e., a staff-level agreement has been reached) or there has been approval in principle (AIP) on a UCT program. Staff must account for the impact of the exceptional circumstances. In general, these will invalidate the agreed program necessitating re-negotiation. In this context, it may be possible to quickly renegotiate and apply a strand 2 and or 3 approach, or a strand 4 Standard Safeguards Approach. Re-negotiations may take longer for strand 1 and the strand 4 enhanced safeguards approach, as more time would typically be needed to sort out the revised balance of adjustment and financing underlying the UCT program design. Where this extra time would extend beyond the period of the emergency, then a UCT program is not feasible within the timeframe of the emergency.

[70] See footnote 40, above, for examples.

89. A subset of RCF/RFI requests may constitute "exceptional circumstances." In particular: (i) the urgent BOP need must arise from exogenous shocks (e.g., adverse shocks to key commodity markets or developments with or in a key trading partner) or natural disasters (e.g., hurricane, widespread flooding); and (ii) the extraordinary demands on the affected government must be such that there is insufficient time for the debtor to undertake "good faith efforts to reach agreement with its creditors." Urgent BOP impacts arising from sources common to all restructuring situations (i.e., the policy-driven endogenous dynamics of a debt crisis) would not be considered "exceptional circumstances". The second prong will typically be met only in cases where arrears have recently arisen and there is no long-standing dialogue between debtor and creditor(s). For debtors with long-standing arrears, the regular arrears policies would apply.

90. The flexibility differs slightly between the LIOA and LIA policies:

- **LIOA policy (Direct Bilateral and some IFI claims)**. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the RCF or RFI despite arrears owed to official bilateral creditors and without seeking creditor consent or assessing whether the three criteria have been satisfied. In order to assess that Fund financing would help advance normalization of debtor-creditor relations, the Fund would require a commitment from the debtor authorities to make good-faith efforts toward resolving the arrears (per the LIOA definition; see Paragraph 62) and to conduct themselves in a way to promote and encourage creditor coordination. The latter could be in the form, for example, of a commitment to ensuring comparable treatment among creditors.

- **LIA policy**. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the RCF or RFI despite arrears owed to private creditors without assessing whether the good-faith criterion has been met. In order to assess that Fund financing would help advance normalization of debtor-creditor relations, the Fund would require a commitment from the debtor authorities to make good-faith efforts toward resolving the arrears.

91. Staff report requirements. Where staff proposes to apply the flexibility under the arrears policies, the staff report should elaborate on the exceptional circumstances, explaining the type of shock and the reason that a UCT program is infeasible and why there is insufficient time for good-faith efforts to reach agreement with creditors. The staff report should also explain how Fund financing will help advance normalization of relations with the creditor(s) and resolution of arrears, including relevant commitments by the debtor authorities.

FINANCING ASSURANCES REVIEWS

92. In order to ensure that financing assurances remain in place over the course of the program, in certain cases the Executive Board must complete a financing assurances review alongside program reviews:[71]

- In **preemptive restructuring** cases (i.e., pre-default) involving restructuring of official bilateral claims until the restructuring has been completed;
- When the Fund is tolerating **arrears on claims to official bilateral** creditors that are expected to be restructured but for which restructuring terms are not finalized;[72]
- When the Fund is tolerating **arrears on debt claims to private creditors**, regardless of whether a restructuring is expected. Where no restructuring of private claims is expected, the financing assurances review requires only a judgment that the LIA policy continues to be met (see Section IV.D); the remainder of this section does not apply.
- Financing assurances reviews are *not* required when arrears to official bilateral creditors exist, but a restructuring is not expected.

93. Financing assurances reviews are supported by provision of indicative information about the expected restructuring process at program outset and at subsequent program reviews. Staff should consult with the authorities and their legal and financial advisors, creditors, and any creditor forum involved to help generate such information.

94. Financing assurances reviews provide the Fund with the opportunity to assess progress in restoring debt sustainability and whether there are sufficient safeguards in place for the further provision of Fund financing. In particular, the Fund needs to determine whether the member's adjustment efforts are undermined by developments in debtor and creditor relationships, and whether in light of progress the existence of arrears (where applicable) is temporary and, therefore, does not undermine the medium-term external viability of the member's balance of payments and its capacity to repay the Fund.[73] The recommendation to complete the financing assurances review requires staff's judgment that, in light of progress made in restructuring the member's debt, the Fund should continue to provide the member with access to Fund resources.

[71] In the listed circumstances, financing assurances reviews are required under any type of Fund-supported program, including those supported by the PCI. For stand-alone emergency financing (i.e., under the Rapid Credit Facility and Rapid Financing Instrument), such reviews are not required, as there are no reviews after approval.

[72] For the avoidance of doubt, financing assurances reviews are required where arrears are "deemed away" under Strand 1 of the LIOA policy until the claims are legally restructured through bilateral agreements between the parties. However, to ensure a smooth transition, financing assurances reviews are only required where "Strand 1" is applied for the first time in a member's Fund-supported program after the April 9, 2024 revision of the LIOA policy.

[73] See Summing Up by the Acting Chairman—Fund Policy on Arrears to Private Creditors—Further Considerations, June 1999; and Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors, December 2015.

95. In some instances, developments may prevent completion of a financing assurances review:

- **If there are indications that the restructuring process is not on track to provide timely or sufficient relief to restore debt sustainability.**
- **If debt sustainability will not be restored by end-program.** The timeline for restructurings will vary among cases, but debt sustainability must be restored by the end of the program. Historically, before arrangement approval, the debt restructuring will have been announced, and steps will have been taken toward reaching agreement. AIP with both official and private creditors would be expected before the first review, with the completion of the debt exchange or bilateral agreements implementing the debt relief by the time of the second review. In theory this process can extend further in the event of technical impediments (and in recent cases it has been more protracted—e.g., Suriname (2021), Zambia (2022), Sri Lanka (2023), Ghana (2023), but it will eventually run up against the expectation of delivery by end-program, forcing an assessment of whether the Fund still has safeguards.

96. Where a financing assurances review would not be able to conclude that sufficient safeguards are in place for the Fund to proceed, the specification of additional safeguards could help address such a problem. In this way, under the LIOA policy, for example, standard safeguards may be added should strand 1 face delays; standard safeguards may be supplemented (e.g., additional conditionality) or even upgraded to enhanced safeguards where strand 4 applies; and enhanced safeguards may need to give way to requirements on actions to deliver on previous assurances (but only if developments call into question the previous assurance in terms of consistency with program parameters or timing). The Fund's Executive Board would have the opportunity, in the context of its Summing Up, to calibrate the message to the debtor and creditors/creditor forum about the urgency in moving through the next envisioned steps.

97. Staff report requirements:

- **Program request** (or, where arrears only arise during the program, the staff report for the first review at which arrears are outstanding). The Staff report should present a clear depiction of the expected steps and schedule for the debt restructuring. As noted above this would be based on information from the debtor and its advisors and would cover key steps (e.g., information sharing, offers, etc.). The timeline would be understood to be indicative, and the staff report would need to be clear that the timeline would be subject to change in the event of material developments. The staff report should also clearly indicate the creditors involved and the process being utilized (e.g., Paris Club, CF, or bilateral discussions). Delays relative to the originally envisioned timeline may not necessarily be an obstacle to the completion of the financing assurances review, provided that the assessment remains that progress is on track to restore debt sustainability in a reasonable time frame within the program period. The financing assurances review must also be provided for in the legal text of the Fund arrangement and the decisions completing the reviews.[74]

- **Subsequent reviews** (i.e., while arrears remain outstanding, or until the preemptive restructuring has been completed). Such staff reports must detail staff's support for the completion of the financing assurances review. This would be expected to include sufficient information to track progress against the indicative schedule to give a clear assessment of the progress with the debt restructuring and whether it remains on track to ensure that overall program objectives are met (i.e., restoring debt sustainability and medium-term external viability). So long as arrears exist or until the preemptive restructuring has been completed, the staff report should provide a clear depiction of steps and an adjusted indicative schedule to facilitate subsequent reviews, as necessary.

Box 2. Sample Financing Assurances Review Language for Staff Report

The following sample language could in some circumstances be sensitive and subject to the Fund's rules on deletions under the Transparency Policy or to more general requirements on non-disclosure of confidential information.

Staff Report for Program Request

On January 1, Debtor announced a restructuring of external debt and hired legal and financial advisors. As part of the restructuring announcement, Debtor declared a moratorium on external debt service payments and is now in arrears to Bilateral Creditors A and B and external bondholders. Debtor and its advisors have held technical meetings with Bilateral Creditors A and B in February and April. The prime minister of Debtor is planning to hold discussions with the president of Bilateral Creditor A in June and with the prime minister of Bilateral Creditor B in July. It is expected that an agreement in principle with official bilateral creditors will be achieved before the first program review. [Assessment of the LIOA policy.] Debtor has conducted preliminary discussions with the creditor committee for bondholders and shared information on the scope of the debt restructuring and preliminary debt targets. Debtor and its advisors expect to make an initial proposal immediately following Board consideration of this program request, with an eye toward launching an exchange in October. [Assessment of the LIA policy.]

Staff Report for Subsequent Review

As anticipated at the program request, agreement in principle was reached with Bilateral Creditor A in August on a restructuring in line with program parameters. While both high-level and technical discussions have continued with Bilateral Creditor B, agreement has not yet been reached. However, it is expected that further discussions [during the Annual Meetings] will allow for additional progress such that agreement in principle within the next few weeks is likely. [Assessment of the LIOA policy.] On the private-sector side, the Debtor and the creditor committee have exchanged proposals. While the Debtor's offer was assessed to be in line with program parameters, the bondholder's offer would have breached the debt target. The Debtor intends to make a counteroffer shortly. While the initial expectation of an October bond exchange is increasingly unlikely, the exchange is still expected before the second program review. [Assessment of the

[74] Please consult with LEG. The provision on financing assurances should follow the one used in the LIA context and should be a continuous condition. For example, in the PRGT context: "[Member] will not request a disbursement under this arrangement … until the Trustee has determined that with regard to each disbursement, for so long as [Member] has outstanding sovereign external payments arrears to [official bilateral creditors], a financing assurances review has been completed." If a financing assurances review is required under both the LIA and LIOA policy, only one financing assurances review covering both types of arrears will need to be completed.

Box 2. Sample Financing Assurances Review Language for Staff Report (concluded)

LIA policy.] Given that the restructuring remains on track to achieve program objectives, staff supports the completion of the financing assurances review.

ROLE OF THE FUND IN THE DEBT RESTRUCTURING PROCESS

98. This section covers the Fund's role in a debt restructuring in the context of expected and existing Fund arrangements. The Fund's specific roles in the context of a Fund arrangement arise from the need to apply the financing assurances and lending into arrears policies. More generally the Fund's role is guided by general principles such as the duty of neutrality and uniformity of treatment.

99. There are several elements to the Fund's role. These include providing analysis and explaining the international architecture for resolution to the member as it decides about a restructuring, setting the restructuring envelope, promoting and facilitating debtor-creditor engagement, and communications.[75] Importantly, the Fund staff cannot perform the functions of financial and legal advisors. These elements are discussed in turn in the sub-sections that follow.

100. Note that the Fund can play a supportive role where there is no Fund arrangement existing or expected.[76] The provisions of this section apply by analogy in that context.

- In the context of its surveillance, the Fund may assess a member's debt as unsustainable. That assessment would be based on a debt sustainability analysis (DSA) showing unsustainable debt with the macro framework projections based on the authorities' current and expected policies. Engagement in the surveillance context can also help provide the analysis needed to set the perimeter for a restructuring.

- Members can request capacity development in the context of their debt restructuring efforts. This can include analysis on debt sustainability and cash flow and assistance on debt management to help build relevant institutional capacity. While it is possible to provide DSA-related capacity development in a restructuring context, this is generally not advisable absent a Fund-supported program to anchor policies (Appendix VIII).

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[75] For analysis, see e.g. Issues in Restructuring of Sovereign Domestic Debt, December 2021; Asonuma, Tamon and Christoph Trebesch, Sovereign Debt Restructurings: Preemptive or Post Default, *Journal of the European Economic Association*, Volume 14, Issue 1, 1 February 2016, Pages 175–214.

[76] For example, the Fund provided independent analysis in Belize's 2007, 2013 and 2017 preemptive restructurings. The 2006 Article IV consultation documents and staff's debt sustainability assessment and cash flow analysis played a central role in setting the parameter for the 2007 restructuring. In December 2006, at the request of the Belizean authorities, the Fund issued an assessment letter to the international financial community, right after the exchange launch.

- Where no up-to-date Fund assessment is readily available, the member or its official creditors may request an assessment letter. Such a letter should contain a clear and candid assessment of the member's macro-economic conditions and prospects and of related structural policies.[77]

A. Supporting the Authorities as they Decide Whether to Restructure

101. When a member requests Fund financing, staff need to explain to the authorities whether debt sustainability problems preclude the Fund providing such financing, unless the member takes steps to restore debt sustainability:

- Any new request for Fund financing must be supported by a DSA, based on realistic macro assumptions and policy measures, showing that debt is sustainable. The Fund utilizes two frameworks for such purposes, the LIC DSF covering low-income countries, and the MAC SRDSF covering all other countries.[78] Staff need to share and explain the results of the analysis in the relevant framework in detail, ensuring that the authorities fully understand all assumptions, calculations, and outputs.

- If the member's debt is assessed as unsustainable, staff should explain that under the Fund's policy framework, the Fund is precluded from providing financing unless the member takes steps to restore debt sustainability over the medium term, including through a debt restructuring. Staff should explain that the debt sustainability requirement is directly linked to the Fund's mandate under the Articles of Agreement to assist members in resolving balance of payments problems under "adequate safeguards". Provision of Fund financing would further exacerbate the member's debt situation since Fund financing is de facto preferred. However, staff should note that debt restructuring is not always the only way to restore sustainability. Countries may also be able to secure grants or highly concessional support from official creditors, with or without a restructuring, that would (help) restore debt sustainability. Such commitments, however, need to be judged by staff as credible and specific or as deriving from a COCP.

- For requests for exceptional access to Fund financing, staff should explain that heightened scrutiny applies, whereby the member must take steps to restore debt sustainability with high probability if the member's debt is unsustainable. However, if the member's debt is sustainable but not with high probability, it must be assessed that the member is receiving financing from other creditors (official or private) on a scale and terms that: (i) help restore the member's debt sustainability prospects and (ii) provide sufficient safeguards for Fund resources.[79]

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[77] Guidance Note on Letters and Statements Assessing Members' Economic Conditions and Policies, January 2018.

[78] See Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries and Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for Market Access Countries.

[79] The Fund's Lending Framework and Sovereign Debt—Further Considerations, April 2015.

102. The decision whether to restructure debt obligations rests solely with the debtor sovereign. It is the authorities who must decide whether and when to restructure their debt, given the staff's assessment and explanation of Fund policies. Even if debt is assessed to be unsustainable, the Fund cannot require a member to restructure its debt, and staff should never make such a representation. As the Fund may be subject to a claim of tortious interference, the staff should not interfere in private contracts. Staff also has a duty of neutrality in respect to disputes between members or between members and other parties. Should the authorities decide to restructure debt, they must manage the restructuring process with the assistance of their legal and financial advisors.

103. Against this backdrop, staff:

- **Should urge the authorities to remain current on their obligations *to the extent possible*.**

- **Should not advise the authorities to take actions that could lead to a default** (including a suspension of payments), either generally or with respect to specific obligations. This is because the Fund cannot interfere with contractual obligations. At the same time, staff should make clear that Fund staff's neutrality on this issue should not be seen as encouragement to put off a needed restructuring or to continue payments to creditors once debt is clearly unsustainable. The decision of whether or not to restructure is for the authorities to make. A negotiated, pre-emptive debt restructuring before payments are missed can be a preferred approach. Indeed, when debt is clearly unsustainable, prompt, and definitive action to restructure debt and restore debt sustainability with high probability remains the least-cost approach.[80]

- **Should encourage the authorities to engage and consult their own legal and financial advisors regarding the design and implementation of any debt restructuring strategy.** When a debtor is considering initiating a debt operation, Fund staff should recommend that the authorities engage legal and financial advisors. These advisors can typically assist the member in conducting an inventory of the debt stock, deciding on restructuring terms, the perimeter, strategies to engage creditors and communication strategy. Fund staff should not advise a member on its sovereign debt restructuring strategy.

B. Setting and Explaining the Envelope for A Debt Restructuring

104. When a member pursues a debt operation in the context of a Fund arrangement, the Fund has an important role to help define the restructuring "envelope" necessary to restore debt sustainability. At the member's request, Fund staff will work with the authorities to define a realistic macroeconomic framework that is adequate to achieve debt sustainability, and which provides for an appropriate balance between adjustment and financing. In specifying this baseline

[80] See the Summing Up in https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/The-Fund-s-Lending- Framework-and-Sovereign-Debt-Further-Considerations-PP5015. Also see Ams et al (2021), "Sovereign Default", in Abbas, Rogoff and Pienkowski (eds.) *Sovereign Debt: A Guide for Economists and Practitioners*, OUP. IMF (2013), "Sovereign Debt Restructuring—Recent Developments and Implications for The Fund's Legal and Policy Framework". Asonuma et al (2024), "Costs of sovereign debt crises: Restructuring strategies and bank intermediation."

program macro framework, staff needs to account for how the restructuring would be expected to affect macro aggregates, the financial system, and the financial markets pricing of debt, exchange rates, and other relevant financial instruments. This also requires among other things an early understanding of perimeter (e.g., domestic debt restructuring can have more notable impacts).[81] It is important for this macro baseline to maintain a central tendency. An optimistic baseline may amplify the tendency to settle for "too little" relief, which ex post can leave the debtor continuing to struggle with debt sustainability. Similarly, a "conservative" baseline will likely lead to more complex restructuring instruments involving contingencies being used in the treatment (i.e., "state-contingent debt instruments" (SCDIs)) which may lengthen the negotiations.

Establishing Debt Targets

105. The Fund should be transparent about the minimum requirements for an assessment that a restructuring would restore sustainability. This would take the form of targets established on relevant DSA ratios. Importantly, it is the Fund's Executive Board that establishes such targets in each country case, on the advice of staff and management, in the context of a program approval or completion of a review. In proposing targets, staff should address the following considerations:

- The targets should establish financing assurances for the program. The targets should generate external financing during the program period in a sufficient scale and timing to close any financing gaps (with domestic financing assumptions consistent with program assumptions on key macro parameters).
- The targets should establish that debt sustainability (i.e., external viability) will be restored. This would typically require a target to cover relevant debt sustainability indicators at a time frame that reflects policies put in place by end program (e.g., DSA stock ratios, such as debt to GDP, or debt to exports or debt service ratios, like debt service to revenues)
- The targets should also establish that the Fund's post-program financing assurances requirements are met (no financing gaps and capacity to repay; see paragraph 94). This would typically require a target to cover relevant flow indicators in the DSA (e.g., gross financing needs or debt service ratios) and ordinarily for 5 years after the arrangement ends.
- There may be specific circumstances where other debt targets are set, in line with the Fund's Debt Limits Policy.[82]

106. It is important that when targets are calibrated in a specific country case, that debt sustainability is fully restored. Restoring sustainability cannot be knife-edge (in which case any adverse shock would tip the debtor back into insolvency). This avoids the inefficiency costs that a second restructuring would entail, which is also important to restore market confidence and catalyze

[81] See, for example, Issues in Restructuring of Sovereign Domestic Debt.

[82] See Guidance Note on Implementing The Debt Limits Policy in Fund Supported Programs.

finance. Against this backdrop, in the context of the Fund's DSA frameworks, the debt sustainability targets should be set as follows:

- **LIC-DSF countries.** The restructuring targets should be set to reduce the risk of debt distress to moderate. This needs to be achieved over the medium-term for normal access cases, and by the end of the program period or three years (whichever is earlier) in exceptional access cases.[83] The moderate risk of external debt distress is assessed for the DSA that would apply at end-program and is typically seen as achieved by the debt indicators (PV of external debt to GDP and to exports, and external debt service to exports and to revenues) declining below the threshold for the relevant debt carrying capacity in 5 years (or earlier, as relevant, in EA cases) from program approval. The assessment would need to account for the overall risk of debt distress if domestic debt is a significant source of vulnerability.

- **Market Access Countries.** The targets should be set to make debt sustainable in normal access cases, and sustainable with high probability in exceptional access cases. These are assessed for a 10-year horizon guided by the medium-term modules of the SRDSF.[84] Given the overarching objective to restore sustainability, in the normal access context the debt targets should be consistent with a probability of sustainable debt that exceeds 50 percent by a sufficient buffer (normally at least 60 percent probability), to avoid the need for subsequent restructurings in the face of moderate shocks. In exceptional access cases, debt targets should be consistent with a probability of sustainable debt that exceeds 80 percent (consistent with how thresholds of the SRDSF are calibrated).

107. Restructuring targets, once set, should only be adjusted under exceptional circumstances. It would be very disruptive to move the targets once the restructuring negotiations have begun, particularly if different groups of creditors have moved at different speeds. That makes the process less predictable and could lead to costly delays. Nevertheless, adjustments may be necessary if a significant change in circumstances requires a different restructuring envelope to restore sustainability (e.g., on the upside, discovery of exploitable natural resource wealth, and on the downside a natural disaster). The inclusion of appropriate buffers when setting the targets (as opposed to barely restoring sustainability) can help ensure that only major downside events lead to adjustment and such buffers are thus in the interest of all parties involved, debtor and creditors alike.

Representing the Restructuring in the DSA

108. The macro framework, targets, and implicit restructuring needs must be effectively communicated through the DSA:

[83] See Supplement to the 2018 Guidance Note on the Bank-Fund Debt Sustainability Framework for Low-Income Countries (LIC-DSF).

[84] Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for Market Access Countries.

- **The initial baseline DSA should show: (i) the evolution of debt aggregates without a restructuring; and (ii) the debt targets.** This allows legal and financial advisors to identify the needed scale of relief. As noted above, the macro framework should assume that a debt restructuring takes place (this approximation avoids the complications associated with modeling the second order macro impacts of slight differences in restructuring design).

- **The baseline DSA can be complemented by an illustrative scenario** (or if appropriate alternative scenarios). These can help demonstrate to the Fund's Executive Board that it is feasible to restore debt sustainability. The illustrative scenario should ordinarily be based on the authorities' restructuring strategy. If the authorities are yet to develop a strategy, staff can use past restructurings as a guide in the construction of an illustrative scenario. The staff report should indicate that any illustrative scenario is one of many possible treatments that restores debt sustainability in a manner consistent with program parameters, and that it should not be interpreted as prejudging the outcome of debt negotiations.

- **Teams can apply judgement in determining what would be most informative scenario to show in DSAs in GRA program reviews.** In cases of protracted restructurings, continuing to present a pre-restructuring baseline DSA until a majority of creditors have reached an AIP on a treatment can help show how the restructuring envelope is changing with underlying macro developments. Teams may however choose to switch focus to the illustrative scenario as the restructuring strategy is implemented. For instance, The OSI treatment can be incorporated on the basis of the financing assurances provided or the application of the LIOA policy, depending on the particular case. PSI can be incorporated on the basis of an assessment of a credible process to reach that treatment. This has been the general practice in MACs, sometimes even at the time of program request, though with some exceptions (e.g., Ukraine). [85] Staff should note that this should in no way prejudge the outcome of the ongoing negotiations.

- **In the case of LICs, the guidance calls for a more conservative approach for program reviews, in line with past procedures**. The baseline generally only reflects OSI treatments when an MoU is agreed with an OCC (or bilateral agreement signed if outside an OCC process) and PSI treatments when a bond exchange or loan restructuring has concluded.[86] Going forward, the decision of whether to include an OSI treatment in the baseline can be informed by the assessment of COCP. The restructuring of residual official creditors can be incorporated on the basis of a representative agreement with a permanent standing forum or other application of the LIOA. Residual private claims can be incorporated in line with the authorities' restructuring

[85] For example, Suriname 2021 EFF and Sri Lanka 2023 EFF.

[86] For example, in the cases of Zambia 2022 ECF and Ghana 2023 ECF, the OSI treatment was only incorporated in the baseline after an MOU was agreed with the OCC (third and second reviews, respectively). The PSI treatment was not incorporated at that point but could be incorporated once an agreement is reached with the majority of private creditors in the debt restructuring perimeter.

strategy or under CoT assumptions, once the settlement has been reached with the majority of private creditors included in the debt restructuring perimeter.[87]

C. Promoting and Facilitating Debtor-Creditor Engagement

109. The Fund should promote debtor-creditor engagement both in preemptive and post-default situations. Once the debtor authorities have decided to restructure, Fund staff should encourage them to engage in an early and collaborative dialogue with creditors to achieve a consensual restructuring. Experience suggests that proactive creditor engagement and a clear communication strategy are key to achieving an orderly debt restructuring with high creditor participation.

Creditor Coordination

110. Staff should promote creditor coordination but cannot insist on specific modalities. The Fund prefers to work with a representative standing forum, and this is in theory possible in most cases. Experience has demonstrated the value of this, e.g., it internalizes information sharing challenges and helps handle COT concerns. Outside of such a context, Fund staff should promote information sharing between creditors (e.g., about any agreements reached), including by encouraging the borrowing member to facilitate this. Failure to share information can become a barrier to completing a financing assurances review (when it undermines debtor-creditor relations and points to delays in the process). Creditor coordination may encompass simultaneous efforts by official bilateral and private creditors, but staff should leave a decision on this type of modality up to the debtor authorities, their advisors, and creditors. Staff should be prepared to support the broader information sharing requirements, if this is the selected modality.

Perimeter, Burden Sharing, and Comparability of Treatment

111. Fund staff should not be involved in issues of setting the perimeter of the restructuring and should only address burden sharing among creditors in limited circumstances. Both roles are the preserve of the authorities and their advisors, and the Fund can typically accept unequal burden sharing either across (official and private) or within creditor groups so long as debt restructuring targets are achieved. In this context:

- **Staff may need to assess and convey to the authorities whether perimeter choices have an impact on the macro framework (and even debt targets).** For instance, in some cases, choices about restructuring domestic law debt held by the domestic financial system may create financial stability issues that would rebound onto the assumed macro framework underpinning the debt restructuring. Relatedly, such choices may also impact broader confidence in the

[87] See paragraph 90 in the Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries, December 2017.

macroeconomy and impede anticipated capital inflows or trigger capital outflows. Also, some perimeter choices could make it all-but-impossible to reach program targets.

- **Staff may need to discuss capital flow management measures (CFMs) that implicate the Institutional View (IV) on the Liberalization and Management of Capital Inflows** [88] Countries may on occasion choose to take temporary measures affecting both capital inflows and outflows in support of a debt restructuring (e.g., Ukraine 2024), potentially to buy time for a restructuring, help speed resolution of debt restructuring, and/or protect debt sustainability in the immediate aftermath of debt restructuring. Staff's discussions should be guided by the IV and country-specific circumstances. There are several cases where the use of CFMs would be appropriate under the IV. In crisis circumstances, restrictions on outflows may be useful as part of an overall policy package tackling the underlying economic imbalances. Where countries have prematurely liberalized, that is where liberalization appears to have outpaced the economy's capacity to safely handle capital flows, it could be appropriate to re-introduce controls while implementing policy actions to address the weaknesses that led to the reimposition of CFMs. Imposition of inflow CFMs could also be appropriate where there is an inflow surge and other macroeconomic policy options are not available. Pre-emptive inflow CFM/MPMs, that is, measures that are also macroprudential in nature, can also be appropriate in some narrow circumstances where capital inflows could contribute to systemic financial risks from stock vulnerabilities.

- **Staff should focus on whether any given course of action regarding burden sharing is likely to achieve the requisite high creditor participation to restore debt sustainability in line with program parameters**. If not, then staff should convey to the debtor authorities that there is a problem.

  - As a corollary, staff should not advise the authorities and creditors on CoT considerations. Creditors assess comparability over different dimensions (NPV reduction, face-value reduction, and maturity extension/financing over the program).[89] Staff may wish to stay apprised of creditor views and to do basic calculations for the Fund's own purposes, however, in support of an assessment of participation prospects.

  - However, there are circumstances where staff must assess whether the debtor is asking for a disproportionate contribution from the creditor relative to other official bilateral creditors. In particular, under the LIOA policy, this is one factor taken into consideration in determining whether the debtor is acting in good faith.

  - Staff should not encourage the payment or non-payment of a *particular* creditor. However, staff may raise to the attention of the debtor authorities if payment of one creditor may

[88] See Review of the Institutional View on the Liberalization and Management of Capital Inflows.

[89] For more details on creditor's views, please refer to the Compendium of GSDR Common Understanding on Technical Issues.

threaten the participation of other creditors in a debt restructuring, including through CoT considerations.

Terms and Conditions

112. Fund staff should not advocate for specific terms and conditions but should help assess whether such terms and conditions (i.e., offers) are compatible with program targets on debt sustainability and financing.[90] The authorities and their advisors must decide on the terms to offer to different creditors (including contingencies). However, the Fund's assessment effectively sets the amount of overall debt relief that needs to be provided, so the authorities need to understand the Fund's assessment about whether such offers meet program targets. Staff should do this assessment when requested by the debtor member and should provide this assessment as quickly as possible. Importantly, because the debtor authorities are the Fund member and staff's counterpart, direct staff engagement with creditors to assess their offers must be authorized by the debtor authorities. In general, the debtor authorities must be a party to any discussions between staff and the creditors unless the debtor agrees otherwise, and it is not staff's role to help creditors engineer the most favorable proposal.

113. In assessing specific terms and conditions, the evaluation of contingencies can raise specific issues. State-contingent elements can include upside instruments, such as warrants tied to oil revenues or specific economic performance indicators (e.g., debt carrying capacity, GDP, etc.). State-contingent elements can also protect the debtor against downside scenarios, such as natural disasters. The same general principle applies here, that staff should not advocate for specific terms, but must evaluate any particular complexities they create, as well as the risk of clawback of relief if official creditors assess that CoT has not been respected. Appendix X discusses state contingencies and the approach applied by the Fund in evaluating them in more detail.

Information Sharing

114. Staff should facilitate debtor-creditor engagement through information sharing (Appendix VIII provides complete details on sharing underlying information with creditors):[91]

- **Fund staff can explain to creditors the macro-framework and the DSA, including the debt targets and financing needs, subject to confidentiality undertakings where appropriate and the consent of the debtor.** Explaining the program and restructuring parameters often necessitates quite extensive exchanges with creditors, including on broader Fund targets (e.g., on reserve adequacy) and policies. Provision of such information may be important to secure financing assurances (whether debt relief or new financing) from official creditors and to advance restructuring negotiations with private creditors (particularly when a default may be

[90] Fund staff should encourage the use of enhanced collective action clauses (CACs). Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring, October 2014.

[91] See Staff Guidance Note on Information Sharing in The Context of Sovereign Debt Restructurings, June 2023.

imminent). Where such engagement requires information not yet in the public domain or approved by the Board, it would need to be subject to confidentiality undertakings.

- **Limitation: the DSA itself should not be shared prior to Executive Board approval of an arrangement.** The DSA forms part of a Board paper and is, therefore, covered by the Transparency Policy and guidance on the publication and preparation of country documents in the April 2014 Transparency Policy Guidance Note.[92] The general rule is that country staff reports and parts thereof (in draft or final form) should not be shared outside of the Fund prior to Board issuance and publication. However, much of the underlying information and assumptions may be needed for creditor decision-making in the course of the restructuring process and this provision does not prevent sharing such information in other formats.

- **In performing this function, it may be also useful for Fund staff to participate in the debtor's meetings with private creditors with the debtor's permission.** While Fund staff should not normally be present when detailed restructuring terms are negotiated with private creditors,[93] it is often useful for staff to attend more general sessions in which aspects of the program and associated debt restructuring targets are under discussion and where staff is in a position to provide useful information in these areas. With the debtor's permission, Fund staff has attended at least one meeting with creditors in almost all restructuring cases over the last 20 years.

- **Fund staff has a long-standing practice of close cooperation with representative standing fora, including under the HIPC initiative.** As part of this, Fund staff typically shares information underlying staff's debt sustainability analysis, provides estimates of the financing envelope for restructuring, and answers creditor questions about the process, the program parameters, and the data. This includes the Paris Club and the official creditor committees formed under the CF where the Paris Club is involved (Chad, 2021; Ethiopia, 2021; Zambia, 2022). See Appendix VIII for more details on interactions with representative standing fora.

- **The Fund staff should also engage with individual official creditors on a bilateral basis, in the context of COCP assessments, providing information as necessary** (see paragraph 15).

Facilitating Negotiations

115. Note that staff may not enter into negotiations on the macro-framework and program assumptions with creditors. There may be circumstances where, following a default, the debtor enters into discussions with creditors prior to the approval of a Fund arrangement. In these circumstances, creditors are likely to express views as to the appropriate dimensions of the program's adjustment and financing parameters. While Fund staff would actively listen to such input, decisions on an adequate macroeconomic framework and the design of the financing plan or

[92] Updated Guidance Note on the Fund's Transparency Policy, April 2014.

[93] Such negotiations can take many forms, ranging from open webinars for all creditors to more restricted engagement with creditor advisors or representatives of a creditor committee.

the adjustment program that could form the basis for the Fund's lending into arrears remain in the sole purview of the Fund.

116. When requested to do so by both the debtor and creditors, the Fund can use its "good offices" to bring the parties together. This function is generally limited in scope and technical in nature, and can involve for example, offering a venue for official creditors and the debtor to meet, and reviewing the nature of the issue and general terms for the settlement of a dispute.[94] However, the Fund does not participate in negotiations or exhaustively analyze the issues, and Fund staff cannot seek contributions from specific creditors on the debtor member's behalf. [95]

Staff Report Requirements

117. Staff reports should describe the developments in debtor-creditor engagement. Much of the information relating to debtor-creditor engagement will be captured already by the staff report requirements for financing assurances, the arrears policies, or financing assurances reviews.

D. Program Conditionality

118. Fund conditionality is sometimes useful to incentivize progress on debt restructuring, to secure financing assurances, and to ensure adequate safeguards for the Fund.[96] In general, the Fund is precluded from lending if lack of progress were to lead to a reassessment that sustainability is restored in a forward-looking manner. Given the criticality of debt restructuring for debt sustainability and financing assurances, the Fund has sometimes used program conditionality to support intermediate steps in debt restructuring processes.[97] LIOA strand 4 also envisions conditionality as appropriate to help establish safeguards for Fund financing to go forward (see paragraph 67).

119. Any use of conditionality on restructuring needs to reflect country circumstances, and to be consistent with the Fund's Guidelines on Conditionality.[98] As such, restructuring conditionality should only be included where the measure is reasonably within the member's direct or indirect control and is either: (i) of critical importance for achieving the goals of the member's program or for monitoring the implementation of the program; or (ii) necessary for the implementation of specific provisions of the Articles or policies adopted under them. Conditionality

[94] *See* The Role of the Fund in the Settlement of Disputes Between Members Relating to External Financial Obligations, April 25, 1984, and Correction 1, May 15, 1984; Acting Chairman's Summing Up, July 13, 1984.

[95] See for example, The Gambia in 2019.

[96] The reference to conditionality here is to prior actions and structural benchmarks that have encouraged progress toward completion of a debt restructuring. While the financing assurances and debt sustainability policies require assurances on a needed debt restructuring as described in the main paper and Appendix XI, conditionality can sometimes be an additional tool to ensure progress through intermediate milestones.

[97] The Fund's Lending Framework and Sovereign Debt – Further Considerations (2015).

[98] Guidelines on Conditionality, Decision No. 12864–(02/102), September 25, 2002, as amended. See also Operational Guidance Note On Program Design and Conditionality, January 2024.

on a debt restructuring can only be included in a Fund arrangement after the authorities have decided to restructure their debt. Conditionality may also not interfere in contractual relationships—e.g., by requiring default or by mandating actions on specific claims.

120. Three types of conditionality may be relevant in a debt restructuring context:

- *Quantitative performance criteria*. Performance criteria on net international reserves and fiscal targets have implications for the ability to service debt and need to be set in a manner consistent with the restructuring strategy.

- *Prior actions*. These cover measures that a member may be expected to adopt prior to the Fund's approval of an arrangement or the completion of a review when it is "critical for the successful implementation of the program that such actions be taken to underpin the upfront implementation of important measures."[99] Where the Fund is asking for safeguards to proceed under strand 4 or more generally under a financing assurances review, this could be appropriate.

- *Structural benchmarks*. These may be established for a measure that "cannot be specified in terms that may be objectively monitored or where its non-implementation would not, by itself, warrant an interruption of purchases or disbursements under an arrangement."[100] Structural benchmarks are intended to serve as "clear markers" in assessing progress in implementation of critical structural reforms in the context of a program review. The Fund will know the indicative timeline and actions for a restructuring (per financing assurances review requirements) and can assess whether any of these actions meet the test laid on in the preceding paragraph.

121. The appropriate actions to target with conditionality would depend in part on whether a restructuring is preemptive or post-default. Given the urgency to avoid a default, negotiations in preemptive cases are normally expected to be more advanced. In such cases, agreement should usually be reached by the first review, or even before approving the request for an arrangement.[101] As such, where conditionality is appropriate, it tends to be set on relatively advanced steps. In post-default cases, programs often allow more time for the restructuring to be completed, and conditionality in such cases would typically consist of intermediate steps towards finalizing the debt operation. Appendix XI summarizes specific program conditionality, as well as commitments from the authorities that were not part of conditionality, included in recent Fund arrangements that involved restructuring of privately held sovereign debt.

122. Restructuring-related conditionality may not be judged necessary, including if the required actions are sufficiently addressed by the arrears policies or preemptive restructuring policy. When formal conditionality is judged not to be needed, it would still be necessary to

[99] Ibid.

[100] Ibid.

[101] The average time between the start and completion among eight preemptive restructurings that took place during 2014-20 was about eight months (see Table 1 in The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors—Recent Developments, Challenges, And Reform Options).

describe the envisioned timeline and actions in the authorities' Letter of Intent (LOI) or Memorandum of Economic and Financial Policies (MEFP), per financing assurances review requirements.

E. Dealing with Fund-Related Conditions Imposed by Creditors

123. In some restructurings, creditors seek to link debt relief to certain Fund-related conditions, which should be discouraged. An example would be where a flow treatment is provided upfront, but a stock treatment falls near the end of a Fund-supported program and is conditioned on successful completion of a certain program review. In theory, such conditions can bring benefits, in so far as they give creditors greater confidence that the debtor will implement their adjustment program. However, they can also entail significant risks, including because they can create uncertainty or put undue pressure on the Fund and Fund staff to make the condition occur, particularly where linked to mechanisms such as debt-relief clawbacks. If such conditions are needed to reach a deal, staff should be clear about two points:

- Certain modalities can reduce the risks, including linking relief to staff-level agreements (rather than Board approvals) and using reward-based (rather than punishment-based) incentives. Appendix XI discusses examples from Fund-supported programs since 2010.

- In any case, staff should not agree to bind the Fund or Fund staff to future actions or deliverables—for example provision of data to the parties on performance on key indicators, publication of documents, or delivery of capacity development—as all Fund engagement is subject to its generally applicable policies.

F. Fund Communications

124. Communications by Fund staff regarding a debt restructuring should be informed by the Fund's role as a confidential and trusted advisor to the debtor member. No confidential information may be shared without the debtor member's permission, either to other parties in the restructuring or to the public. In general, staff should defer to the authorities to handle communications, though staff may "correct the record" with a factual statement on process, if needed. The member should clear with Fund staff how staff views on a potential proposal are represented in any cleansing statement. Should Fund staff be asked about its role, a factual statement on staff's actions—e.g., participation in discussions, explanation of the macro-framework to creditors, or provision to the authorities of staff's assessment of a proposal—may be appropriate, but providing details about staff's confidential advice or assessments requires the authorization of the authorities.

125. A public statement by the Fund's Managing Director or by Fund staff may sometimes be useful to encourage dialogue and creditor participation, if requested by the debtor authorities. This may be particularly relevant when a deadline is approaching, often associated with an exchange or offer to private creditors launched by the authorities. Consistent with this, in several restructurings, Fund management has facilitated debtor-creditor engagement by issuing press statements underlining the importance of completing the restructuring.[102] Statements should not support particular restructuring terms/offers, given that the Fund is agnostic on the specific terms so long as they meet program targets, but should instead support the efficient resolution of the restructuring. A statement confirming consistency with program parameters could be useful to reassure the parties involved. Given that such statements can be highly sensitive, they should first be discussed and reviewed by the Communications Department, the Monetary and Capital Markets Department, LEG, SPR, and management.

126. Staff should explain Fund policies and their application to relevant creditors. Questions from official creditors about how they are being classified for the purposes of Fund policies, and whether they will face application of the three criteria or be "deemed away" are particularly sensitive. Especially when dealing with private creditors' legal and financial advisors, it is strongly recommended to involve SPR and/or LEG in the discussion.

127. Fund staff and Management can also help obtain financing assurances from official bilateral creditors and IFIs. Such efforts should always be led by the debtor country authorities. Staff can support their efforts, for example by meeting with creditor country EDs or authorities to explain program parameters and Fund policies. Where needed, such efforts can be escalated to Fund Management level.

[102] See, e.g., Uruguay 2003, Dominican Republic 2005, Belize 2006, Greece 2012, Ukraine 2015, Chad 2021, Zambia 2024, Ukraine 2024.

Appendix I. Application of the Financing Assurances Policy to Members Facing Exceptionally High Uncertainty and Requesting a UCT-Quality Program[1]

1. In most cases of exceptionally high uncertainty, emergency financing through the Rapid Financing Instrument and/or Rapid Credit Facility would generally be the appropriate modality for the Fund to support members with urgent BOP needs. There are no unique procedures in such cases, and the normal requirements regarding debt sustainability, capacity to repay and other policies would apply.

2. However, stronger Fund engagement in a UCT context with a member facing exceptionally high uncertainty might be deemed appropriate and consistent with Fund policies in certain cases. In these latter cases, which are expected to be extremely rare, the procedures in this appendix would apply.

3. Staff must first assess whether "exceptionally high uncertainty" applies. This is characterized by a combination of several factors:

i. It originates in an exogenous shock; that is, an ongoing shock to a members' economic capacity that originates in factors beyond the authorities' control.

ii. The impact of the shock on the economy depends on events fundamentally outside of the control of the authorities' economic policies, at least in the near-term.

iii. It therefore involves severe and continuing balance of payment impacts, making the scale of the BoP challenge difficult to assess with the usual degree of confidence associated with UCT lending (although there could still be a credible basis for assessing that UCT requirements are met). An example is a shock in the form of a large-scale war.

iv. No one scenario that characterizes the evolution of the ongoing shock can be seen as sufficiently "central," and indeed the situation involves significant adverse tail risks where the shock and/or its impacts could continue beyond the usual Fund program timeframe.

v. The ability of official bilateral creditors to ensure debt sustainability through upfront debt write-downs is impaired due to the lack of a sufficiently "central" scenario and given the presence of large downside risks, and broader sources of financing must be catalyzed to help resolve the BoP problem.

4. For a member facing such uncertainty, a procedural safeguard is required to launch Fund engagement. This would generally be expected to be in the form of an informal meeting to engage Executive Directors, but it may be a formal Board meeting if considered appropriate. Such

[1] Changes to the Fund's Financing Assurances Policy in the Context of Fund Upper Credit Tranche (UCT) Financing Under Exceptionally High Uncertainty, March 2023.

engagement should predate any program negotiation mission. The Board would need to consider the issue of whether exceptionally high uncertainty exists, as defined above, and whether the Fund would be prepared to accept higher risks, and pursue an arrangement, if the member has requested it at that point. A Board determination that exceptionally high uncertainty exists in a specific case would not be a guarantee that the Fund could provide UCT-quality financing; any request for Fund financing would need to be assessed on its own merits, in line with applicable policies.

5. Program design would have to take into account the exceptionally high uncertainty. Instead of a program around a central scenario—the Fund's standard approach—these cases would require designing a program that can work in a range of scenarios, to give enough confidence that it will work. In essence, the agreed policies and reforms must be designed to restore medium term viability, notwithstanding the inherent uncertainty about any one scenario. To implement this in practice, two sufficiently separated scenarios should be set out (thus also giving confidence about scenarios in between):

a. **A baseline scenario built on an assumption about how the exogenous factors driving the exceptionally high uncertainty evolve (e.g., a large-scale war winding down).** This scenario would need to resolve the BoP problem and restore medium term external viability per standard UCT requirements. This requires, among other things, a detailed DSA that indicates that debt sustainability can be restored over the medium term, together with adequate financing assurances to ensure that the program is fully financed and that there are adequate safeguards including on the member's capacity to repay the Fund.

b. **A downside scenario capturing the significant risk that the exogenous factors driving the exceptionally high uncertainty persist.** This should aim to push assumptions to the limit where a Fund-supported program would still be able to meet its objectives (thus maximizing confidence that there is a space for a program to work). This would require a combination of contingent adjustment policies and external financing that would still address the BoP problem and restore medium-term external viability while providing appropriate safeguards in that scenario, including with respect to capacity to repay the Fund (and taking into account any grants and/or highly concessional financing committed by donors as a backstop).

6. This type of program design would require:

a. Program assumptions on baseline and downside scenarios that are consistent with the country context at the time of arrangement approval and at subsequent reviews. Since the shock would typically originate in factors beyond the control of economic policies, such assumptions would lie beyond the competency of Fund management and staff. Accordingly, management and staff would be expected to draw on the expertise of other organizations to help guide judgment.

b. An assessment that the member is sufficiently committed to and has the capacity to implement the program. This includes confidence that the member would have sufficient economic policy control to implement the program from the outset and would provide necessary data for the Fund to monitor program implementation. This could require establishing a track record (e.g., under a staff monitored program, or PMB).

c. A program of sufficient length to provide the member more time to adjust, with some room to accommodate a wider range of assumptions and greater scope to adjust the program per the downside scenario contingency plan if the situation persists longer than envisaged. Note that if exceptionally high uncertainty lasts too long, there may be insufficient time left for the member to adjust to achieve medium-term external viability. At this point, with the program no longer able to achieve its objectives, it would no longer be feasible to complete program reviews and continue with it.

d. Sufficient donor support, on appropriately concessional financial terms, committed to cover the program period and beyond. This includes a clear commitment of contingent donor support on appropriately concessional terms to complement stronger policy adjustments needed under the downside scenario (to strengthen the case at the arrangement approval that the program can deliver notwithstanding exceptionally high uncertainty).

e. Financing assurances from donors and creditors regarding debt sustainability (on both the baseline and downside scenario).

f. Adequate safeguards for repayment to the Fund, including in tail risk scenarios beyond the downside scenario.

7. Before proceeding, a judgment would need to be made that such a UCT program design would be feasible and credible, and consistent with legal and policy requirements for Fund lending including adequate safeguards. Management and staff would need to do this before circulating a UFR request to the Board at the time of approval of the arrangement as well as at subsequent reviews. To the extent the exceptionally high uncertainty dissipates, the situation would go back to a standard Fund approach built just around the baseline. If it remains, then program reviews would need to continue to preserve the structure of two feasible scenarios and be able to assess that the two scenarios remained sufficiently separated to give confidence. If the exceptionally high uncertainty were to escalate or continue for too long, then the level of confidence could become sufficiently low that management and staff would not be able to clearly and credibly establish a program design—including a feasible downside scenario—that would resolve the member's BoP problem. Further Fund lending under the arrangement would become infeasible.

8. The form of financing assurances from official bilateral creditors in cases involvement exceptionally high uncertainty would be different from the normal approach.[2] In such situations, where a restructuring is always necessary, official bilateral creditors would be expected to

[2] The approach to financing assurances from the private sector remains unchanged from normal cases (see paragraph 19 on credible process).

deliver credible assurances upfront, but with a second-stage contingent element. Thus, they would provide:

a. An upfront "credible and specific" assurance covering what is needed in the baseline scenario to restore debt sustainability. This could be cast as a flow then stock treatment (per HIPC), although the scale of the second stage debt relief commitment would need to be clear to help condition expectations of the other creditors expected to restructure in the interim (e.g., the private sector, which would not be eligible for such an approach under Fund policies).

b. An upfront assurance to provide the necessary financial support to restore debt sustainability in a second stage once the exceptionally high uncertainty abates within program (or based on a best estimate at the last program review, whichever comes first). The program's downside scenario would provide an upfront estimate of the possible scale of the needed financial support, in the event outcomes are more adverse. In line with standard program practice, scenarios would be updated at each program review and financing commitments updated if necessary, providing full transparency to creditors and donors and control over their commitment.

Together, these would also help establish the ability of the program to resolve the BoP problem by restoring debt sustainability. The assurances would be given by a recognized creditor forum, and/or directly (in line with the Fund's standards for such assurances.)[3]

9. The approach to financing assurances from private creditors would be broadly consistent with standard approaches, but with some nuances reflecting the circumstance:

- Where arrears exist to private creditors, the LIA policy requirements would apply, and the two criteria of the policy must be met (see section IV.D above). The nuance is that extra flexibility is needed in the assessment, as it may not be possible to reach an agreement before the end of the exceptionally high uncertainty (which may take some time). Any agreement reached would of course need to be viable up to the downside scenario (implicating contingent features which would need to be carefully evaluated).

- In some circumstances, creditors may agree to a standstill, or a restructuring keyed to the "baseline," leaving the situation in pre-default and insufficient to restore sustainability across the range of scenarios between the baseline and downside. Staff must then assess that a credible process exists to deliver the necessary restructuring. Staff should judge this by reference to several factors: (i) whether the authorities have announced the final restructuring; (ii) the consistency of their communications to creditors about program parameters in the context of the standstill and expected second restructuring; (iii) their retention of legal and financial

[3] Note that in some circumstances restoring sustainability might go beyond debt relief to a need for financing on highly concessional terms. The mix of relief and new financing is within the discretion of the creditors/donors, provided it adds up to provide the required financing. For new highly concessional financing, the requirements for standard financing assurances would apply.

advisors; and (iv) sharing of relevant information with creditors, including the potential envelope for the restructuring under the program space between baseline and downside.

10. To support a request for UCT financing by a member facing exceptionally high uncertainty, the Fund would require an assurance on the member's capacity to repay the Fund from official creditors/donors for safeguards purposes. The assurance:

a. **Should be extended by a significant group of creditors/donors.** Considering the long potential timeframe during which an assurance could be outstanding, having a significant group of creditors/donors would help ensure that adverse changes in individual members' external position would not undermine the credibility of the assurance. Generally, a "significant group" would represent at least 50 percent of voting power at the Fund's Executive Board. Individual members of the group should be participants in the Fund's Financial Transactions Plan and have a collective history of contributions to multilateral debt relief initiatives commensurate with the scale of their collective assurance.

b. **Would confirm the creditors'/donors' recognition of the Fund's de facto preferred creditor status** (PCS) and complement the Fund's risk management framework with the aim to prevent any overdue financial obligations to the Fund from the borrowing member and to thus establish "ex ante" adequate lending safeguards. Management, staff and the Board would need to assess at program outset and each review that scenarios which would give rise to any overdue financial obligations are very unlikely, and adequate safeguards for Fund lending are in place as required under the Articles.

c. **May take different forms but would need to be public.** The joint nature of the assurance would leave space for the group to manage different domestic processes. The Fund would not prescribe ex-ante any expected burden sharing. Normally, a public statement from the creditors or a suitable written statement from the Executive Directors representing the relevant official bilateral creditors/donors, on behalf of their country authorities, would suffice to provide the assurance. The statement would need to be in the public domain; in the case of a statement conveyed by Executive Directors, publication could be via the staff report, which should include a clear reference.

d. **In the event that Fund financing commitments were proposed to be augmented, the group of creditors/donors would need to extend their assurance accordingly**.

e. **This type of assurance would cease to be effective upon approval of a new arrangement for the member** (unless specifically renewed, for example, because of a continuation of the exceptionally high uncertainty).[4]

[4] The assurance would also become ineffective if a member can no longer exercise its rights and obligations in the Fund (e.g., where there is no government recognized for the member by the international community).

11. When a member facing exceptionally high uncertainty seeks emergency financing, safeguards beyond those described in Section IV.F may be needed to ensure the restoration of debt sustainability. One approach is to receive assurances from creditors that cover both debt relief and capacity to repay, in line with the assurances laid above.[5] Given the broader messaging problem for the Fund and the damage this could inflict to the Fund's ability to catalyze full assurances in future circumstances, this approach should only be considered in a stand-alone RFI/RCF context, and in a true emergency where other options to secure assurances are not feasible. In the event that assurances in emergency financing situations are established using these modalities, the Board should be duly informed to confirm that it is prepared to take the added balance sheet risk (and other enterprise risks involved). To this end, an early engagement with the Board could be pursued, supported by short documentation. Staff could explain in the documentation that: (i) access to Fund resources is urgently needed and there is no time to agree on a Fund-supported program; (ii) adjustment and financing safeguards would be sought, including details; and (iii) there is an international effort to support the member and the Fund is called upon to act. Such an early engagement would also put official creditors on alert about their anticipated contribution and the need for the requisite assurances. Following the RFI/RCF disbursement, a follow up process involving the Board would be needed to report on progress (e.g., through surveillance or post-program monitoring modalities, where relevant).

[5] This corresponds to the approach used in Iraq in 2005, Lebanon 2007, and Ukraine 2022.

Appendix II. Approval in Principle

1. The Fund has a procedural tool—AIP—to bridge engagement gaps while safeguards are sought. AIP is a procedure that involves:

- A first decision by the Board approving a Fund arrangement in principle based on a complete understanding between the Fund and the member on policies, but where financing assurances have not been secured.

- Once the financing assurances have been obtained, a second decision by the Board is required for the arrangement to become effective, and this is adopted on a Lapse of Time (LOT) basis.

2. The AIP procedure entails specifying several elements:

- *The period between approval in principle and effectiveness of an arrangement.* The first decision to approve in principle must specify a date by which AIP would lapse, i.e., a deadline by which the second decision must be adopted on a Lapse of Time (LOT) basis. Factors in determining the deadline include the need to ensure that the program would not become stale, the need to ensure that the program was indeed being implemented and the need to ensure that delay would not distort the phasing under the arrangement. This deadline can usefully align with the expected timeline in a program for a review, which is about 3-4 months in rapidly evolving situations.

- *A timeframe and circumstances under which the AIP can be renewed.* Such a renewal would normally be subject to a limit of 3-4 months (implying a maximum AIP period of 6-8 months) and such an update is only allowed once with respect to an arrangement request. Note that the member's right to request a new program at any point would remain, but there would be a strong incentive to stay within AIP to avoid creating questions about capacity to implement a program.

- *Renewal requirements.* An AIP can only be renewed if the use of the AIP tool is still considered worthwhile; that is that the effort to establish necessary safeguards would still be on track and likely to deliver. To complete a renewal, staff would need to assess that the overall program is being implemented and remains on track. Concerning the latter, new information may require minor updates (e.g., to adjust availability dates and test dates), but could also require more significant macro-framework updates, and/or updates where there are implementation issues to be corrected. Prior actions would be expected to correct any implementation shortfalls, and could draw on conditions in the original program, with any use consistent with the Guidelines on Conditionality. The proposed extension and new LOI/MEFP/TMU would need to be put forward for full Board consideration, supported by a new staff report. The Board would need to be informed if AIP would be allowed to lapse without renewal or achievement of the second condition, including an explanation of the reasons for this.

- *The required safeguards*. In a restructuring context, the requirements under the financing assurances policy and the LIOA policy would have to be met to proceed. As discussed above, these could be broader than just financing assurances. The Fund would require adequate safeguards to proceed. These safeguards accordingly would need to be clearly specified in the conditions required for the second decision under AIP (i.e., to make the arrangement effective) for such a program involving a debt restructuring.

3. Program design under the proposed adjustments to the AIP framework would need to recognize and be robust to the possibility that the safeguards noted above might only be received during the extended period of the AIP. This can be handled with suitably conservative financial programming combined with the use of adjusters (i.e., on targets that would be affected if the financing assurances and thus Fund disbursement arrive earlier or later than expected). Note that it would be possible for program design to be based on semi-annual reviews notwithstanding a possible AIP renewal in three months (and in this instance a set of Indicative Targets at the three-month point would be essential to support AIP renewal).

4. It is important to emphasize that AIP is a potential tool, not a requirement. Its use would be governed by the circumstances. In all cases staff should aim to bring a UCT program forward as fast as possible (utilizing the proposed Strand 4 under LIOA and tools like stand-alone DSA approval to overcome information sharing barriers towards securing safeguards). In some circumstances, consultations with a standing forum, other official bilateral creditors, and the debtor countries' debt advisors may reveal that more time would be needed to secure the necessary safeguards, especially if enhanced safeguards under Strand 4 are deemed necessary. In these instances, AIP could be a good option to pursue. The Fund's Executive Board would have the opportunity, through the Summing Up, to calibrate the message to the debtor and creditors about the urgency in supplying the necessary safeguards.

Appendix III. Recording OSI-Related Arrears in the DSA

1. Arrears deemed resolved based on an adequately representative agreement by a representative standing forum should be recorded in the DSA after applying the terms of the Agreed Minute (or the MOU in the context of an agreement in the CF with Paris Club involvement). Ideally, both stocks and flows would be recorded on that basis. But in practice, this could prove too difficult and onerous to country teams. Moreover, given the substantial uncertainty over the actual timing of the restructuring agreement and the eventual cashflows, teams may be uncomfortable with reporting a medium-term financing need (and associated debt and debt service vulnerabilities) that is unlikely to materialize. In light of these considerations, teams may record only the stock of arrears in the DSA, unless there is confidence that the treatment will materialize. That stock should be recorded after applying a haircut compatible with the representative standing forum's agreement (ideally the NPV haircut). That information, as well the appropriate currency-specific interest rate is readily available for HIPC cases with legacy arrears. The interest rate used should be guided by comparability of treatment (CoT) with the agreement (not the interest rate under the original terms) and no penalty interest should be included on that post-treatment debt stock. Since this approach approximates but may not be fully consistent with CoT (whose assessment is the prerogative of creditors), a disclaimer should be included in the DSA write-up to the effect that this representation is an approximation of CoT. The DSA should also mention that additional financing needs could emerge if/when an agreement is reached.

2. The full stock of unresolved arrears should be reported in situations where the LIOA relies on creditor's consent to legacy arrears not covered by a representative standing forum agreement. This assumes that such recording in the DSA would be consistent with debt sustainability.

3. In situations where debt sustainability relies on the application of strands 2, 3 or 4 of the LIOA, the recording of the arrears and future debt service will be based on the program parameters. This requires a judgement that the arrears will eventually be restructured in line with the program parameters. That is, where successful holdout behavior by that creditor is unlikely even after the program, and such holdout risk will not impede progress with official and private restructuring where needed to restore debt sustainability. If those safeguards are met, debt sustainability and program financing may hinge on that assumed debt treatment on the basis of the creditor's consent (e.g., the application of the LIOA in Suriname's 2021 Fund-supported program). These safeguards will by construction be met in applications involving the fourth strand of the policy. The DSA and staff report should make clear that even when a creditor has consented to the arrears, it has not committed to providing such relief, so as not to prejudge the eventual treatment or be perceived as the Fund interfering in the debt-creditor relations.

Appendix IV. Credible Official Creditor Processes, Illustration

1. To help illustrate the concept of "credible official creditor process" (COCP), a generic internal process for creditors is considered, together with the approach expected to be taken to assess it as COCP. The illustrative example abstracts from creditor-specific circumstances that can diverge from the generic case, but these can be readily incorporated.[1]

2. A typical creditor arrangement within a public sector would involve several layers (each with delegated authorities):

- Lending agencies (e.g., Export Credit Agencies (ECAs), government-owned development banks). These would typically have an ability to agree to restructuring of the terms of their loan contracts up to certain amounts).
- Oversight agencies (e.g., ministries). These would typically set limits for the creditors in their purview and take decisions on debt relief beyond their delegated authority.
- Internal coordinating body. This could be the Ministry of Finance (MoF), or maybe a group of ministries including others such as the Ministry of Foreign Affairs (MFA), and Ministry of Economy (MoE).
- External coordination representative. This would typically be someone from the internal coordinating body with delegated authorities to act on behalf of all lenders in the context of a standing forum for multi-country creditor coordination.

3. Against this backdrop, a typical internal creditor process for a restructuring request would involve the following stages:

i. *A request from the borrower to the lenders*. If lenders have delegated authority to deal with the request (e.g., a simple reprofiling request), and there are no external coordination issues, then lenders would typically inform their respective oversight agency and address the request directly. Where an external coordination issue arises, they would also inform their internal coordinating body/ministry.

ii. *Launch of the relevant internal process for considering the restructuring request*. The creditor, or internal coordinating body/ministry, once informed, would obtain debt information from all affected loans and lending agents, and activate any external coordination mechanisms to which it is a party.

iii. *Understanding the envelope for the debt restructuring and its impact*. Either through the borrower's financial advisors, or through the external coordination mechanism, information

[1] See examples of PC creditor processes in Appendix III of Policy Reform Proposals To Promote The Fund's Capacity To Support Countries Undertaking Debt Restructuring, April 2024.

would be collected by the internal coordinating body about the gap to be filled (DSA and macro framework) and the broad perimeter for the restructuring (possible loans which could be subject to restructuring). The internal coordinating body would consult with lenders about any issues that would arise for them under this structure (i.e., approvals, compensation through the budget process), and any special loan terms that might bear on the restructuring (e.g., guarantees, collateral, etc.) and would communicate this to the external coordination mechanism (if relevant).

iv. *Establishing a potential framework for the restructuring*. Either in direct consultation with the borrower's financial advisors, or through the external coordination mechanism, the broad contours of a framework for restructuring the debt would be laid out: perimeter (including cut-off date); possible terms and conditions; and timeline. The internal coordinating body would again consult with lenders about any issues that would arise for them under this framework. If it was satisfied that a framework was likely to prove possible, the internal coordinating body would summon a meeting for a decision.

v. *Formal decision by the internal coordinating body about whether to engage on the basis of the proposed framework*. This would include any necessary contingent authorizations to the lenders and contingent approvals of transfers to them. This may involve a subsequent similar decision at the level of the external coordinating body (in which case the external coordination agent would be given a mandate).

vi. *Engagement with the borrowers' advisors to reach an agreement in principle.* This could be done either directly or through the external coordination mechanism. Novel terms and conditions will tend to extend this stage.

vii. *Finalization of the new loan terms and conditions with the borrower*. Again, novel terms and conditions will tend to extend this stage.

4. Note that IMF staff and Management would typically be available to support this process at every stage. Staff will interact with and support a creditor's internal process, by providing information and answering questions on a timely basis upon request. For example, in stage 1, staff would provide support to borrowers to liaise with relevant creditors, though the actual communication should come from the borrower's authorities to its creditors. Staff would also work with the borrower's authorities to support their debt reconciliation exercise, at times in collaboration with other partners such as the World Bank (such as in the HIPC process). In stage 3, staff will provide inputs (e.g., to borrowers' financial advisors) related to restructuring targets based on the macro-framework and DSA produced by staff. In stage 4, staff will provide inputs on any program arrangement and the macroeconomic forecast of the, especially to the external coordination body. For all other stages, staff and Management will stand ready to support borrower's authorities and creditors (and any external coordination bodies) with relevant inputs and clarifications.

5. There are several candidates for what could constitute a "key stage" in the creditor's process (i.e., a stage beyond which an outcome would be virtually ensured, i.e., contractually finalized debt relief and/or new financing consistent with program parameters). All of stages 4 through 7 could qualify, and for some types of creditors with strong and robust track records, even conceivably stage 1. What would matter would be the track record of the creditor in delivering. For a new creditor with unknown processes, stage 7 might even be necessary, but with improvements in the track record, stage 4 could become feasible. For a stage 1 request to be a "key stage", the track record would need to show an automaticity (which might be possible for a simple reprofiling).

6. Management and staff would need to be able to understand a creditors' individual internal process (i.e., where an external coordination mechanism is not available to play this role). Staff needs to be satisfied that the process would be proceeding on the basis of program parameters conditional on disclosure restrictions (stage 3), and then assess what level of decision/outcome would be needed in light of the track record. Note that once the internal process would be understood, a track record established, and a "key stage" identified, a simple communication from the creditor that the "key stage" had been reached could suffice. Shifting that key stage would require reconfirming the internal process and additional track record. Staff would be in a position to do this through its support to the process (see paragraph 4).

7. The assessment of the key stage is a dynamic process and can be tightened if a creditor's track record weakens. Assessment of COCP allows for adjusting the identification of the key stage to a later part of the internal process if the process fails to advance further than the key stage established earlier, to deliver required debt relief and/or new financing consistent with program parameters – weakening the track record of the creditor.[2]

[2] In the absence of sufficient information or a robust track record to make such an assessment, required financing assurances could continue to be satisfied by specific and credible assurances (SCA) on debt relief/financing.

Appendix V. Defining the External Payment Arrears Performance Criterion in Fund-Supported Programs

1. Fund-supported programs typically have a continuous performance criterion setting a zero ceiling on external debt arrears. External arrears for purposes of the continuous performance criterion are normally defined as obligations on external debt that are not paid on the due date specified in the underlying agreement, taking into account any applicable contractual grace periods. The performance criterion excludes arrears on external debt "subject to rescheduling," which refers to claims under active renegotiations—i.e., the debtor reached out to the creditor *before* arrears arose to seek debt relief. Because the performance criterion is continuous, reporting also needs to be continuous.[1]

2. The performance criterion may be tailored to member circumstances, with due regard for uniformity of treatment. When the specific circumstances of the member are such that there is limited capacity to monitor specific forms of external payments per the due date as specified in the underlying contractual terms, it may be appropriate to have a definition of external payment arrears that deviates from the underlying contractual terms. A determination needs to be made on a case-by-case basis; it would be important that any exceptional treatment along these lines would relate only to those types of payments where specific monitoring challenges arise. In the event of weak monitoring capacity, there should be a focus on helping the authorities improve their monitoring capacity over time. The authorities should be made aware that any deviation in the definition of external payment arrears for purposes of the performance criterion would not preclude the creditor from exercising its contractual enforcement rights. The Fund should not be perceived as interfering in contractual relations.

3. *Template language for technical memoranda of understanding.* All scenarios assume there are definitions for "debt" (e.g., as in the Debt Limits Policy) and "government".

- *Regular cases:* For purposes of the PC on the non-accumulation of new external payment arrears, arrears are defined as external debt obligations of the government that have not been paid when due in accordance with the relevant contractual terms (taking into account any contractual grace periods). This PC excludes arrears on external financial obligations of the government subject to rescheduling.

- *Low capacity to monitor debt payments:* For purposes of the PC on the non-accumulation of new external payment arrears, arrears are defined as external debt obligations of the government that have not been paid within 30 days of the contractual due date or within the contractual

[1] Failure to report deviations immediately could lead to misreporting—for example if a deviation were to arise between the last reporting of data and a Board review. Either the definition of the PC or the reporting section of the TMU should include language along the following lines: "This PC is monitored continuously by the authorities and any occurrence of new external arrears shall be immediately reported to the Fund."

grace period, whichever is later. This PC excludes arrears on external financial obligations of the government subject to rescheduling.

- *Cases where the government is not immediately notified of guarantee being called (e.g., public-private partnerships)*: For purposes of the PC on the non-accumulation of new external payment arrears, arrears are defined as external debt obligations of the government that have not been paid when due in accordance with the relevant contractual terms (taking into account any contractual grace periods). External payments arrears on external debt service obligations in respect of public private partnership projects (which are defined as (i) infrastructure projects which involve the (ii) granting of a government guarantee and the (iii) participation of a public corporation subject to control by the government) are not included in the coverage of this external arrears PC, unless these payments are made after [30] days from the contractual due date (including any contractual grace period). This PC excludes arrears on external financial obligations of the government subject to rescheduling.

Appendix VI. Calculating Whether an Agreement is "Adequately Representative"

The table below illustrates with a numerical example how to identify whether a Paris Club agreement is "adequately representative" for the purposes of the Lending Into Official Arrears policy. The table shows the estimated balance of payments (BOP) need over the program period and the sources of financing to cover it (this table is akin to the "external financing requirements" table in staff reports). In this particular example, Paris Club creditors account for more than 50 percent (55 percent to be precise) of the contributions provided and/or required from official bilateral creditors. Hence, a Paris Club agreement in this case would be considered adequately representative and official bilateral arrears would be deemed eliminated for the purposes of the policy.

Description	**Definition**	**Cumulative $ Years 1 to 3**	**Shares**
External financing needs	A = A1 + A2 + A3 + A4 + A5	2000	
Current account deficit excluding official grants and interest payments	A1	700	
Increase in gross international reserves	A2	600	
Debt service due to private creditors 1/	A3	400	
Debt service due to multilateral creditors	A4	0	
Debt service due to official bilateral creditors 1/	A5 = A51 + A52	300	
Paris Club	A51	200	
Non-Paris Club	A52	100	
External financing sources	B = B1 + B2 + B3 + B4 + B5	1500	
Foreign direct investment	B1	500	
Other financial account flows (other than the financing items below)	B2	0	
Financing provided by private creditors (including debt service relief)	B3	300	
Financing provided by multilaterals (including net Fund purchases and grants)	B4	200	
Financing provided by official bilateral creditors 2/	B5 = B51 + B52	500	
Paris Club	B51	400	
Non-Paris Club	B52	100	
Residual: financing required from but not yet provided by official bilateral creditors 2/ 3/	C = C1 + C2	500	
Paris Club	C1	150	
Non-Paris Club	C2	350	

Description	**Definition**	**Cumulative $ Years 1 to 3**	**Shares**	
Memo item:				
Total contribution by official bilateral creditors	D = D1 + D2	1000	100%	
Paris Club	D1 = B51 + C1	550	55%	√
Non-Paris Club	D2 = B52 + C2	450	45%	

1/ This example assumes that part of debt service coming due is canceled or rescheduled.
2/ It may include grants, new financing, as well as debt service relief.
3/ In this example, it includes all debt service relief provided plus new financing.

As this table illustrates, to calculate the majority share, country teams must obtain in advance data on: i) official bilateral debt service falling due during the program period; and ii) new financing provided/committed by official bilateral creditors during the program period (as reflected in the BOP projections).

Appendix VII. Model Language for Policy Notes and Staff Reports

Dealing with, and Reporting on, Cases Involving "Legacy" Arrears to Official Bilateral Creditors in Fund-Supported Programs

Country	Assessment	Reporting of arrears/best efforts	
		Policy Notes	**Staff Reports**
Paris Club Agreement is adequately representative	First, confirm that arrears in question relate to a debt which is covered by the Paris Club Agreed Minute (i.e., pre-cut off date debt). Second, assess whether HIPC case or non HIPC case. **HIPC cases: one-off simplified** (teams can use Tables AIII11 and AIII14 in the annual *HIPC Statistical Update* or the table on the *Status of Creditor Participation Under Enhanced HIPC Initiative* in HIPC completion point reports to calculate representativeness. **Non-HIPC cases: one-off** (use information from the staff report closest to the Paris Club agreement)	**Every review (until arrears are resolved):** *Language for PN:* Staff will convey to the authorities that [pre-HIPC Initiative arrears to non-Paris Club creditors] [arrears to "XXX"] can continue to be deemed away under the arrears policy for official bilateral creditors, as the underlying Paris Club agreement is adequately representative and the authorities have made best efforts* to resolve those arrears. Staff will emphasize to the authorities the importance of continued best efforts* in this regard.	**One-off (footnote) [until a creditor ED raises the issue]:** *Language for SR:* Country X owes [pre-HIPC Initiative arrears to non-Paris Club creditors] [arrears to "XXX"] which continue to be deemed away under the policy on arrears to official bilateral creditors, as the underlying Paris Club Agreed Minute is adequately representative and the authorities have made best efforts* to resolve the arrears. [If there is a development in the debtor-creditor relationship, or if a creditor raises the issue through the ED in subsequent reviews, it would be required that the SR include a reference to best efforts*]
Paris Club Agreement is <u>not</u> adequately representative	First, confirm that arrears in question relate to a debt which is covered by the Paris Club Agreed Minute (i.e., pre-cut off date debt). Second, assess whether HIPC case or non HIPC case. **HIPC cases: one-off simplified** (teams can use Tables AIII11 and AIII14 in the annual *HIPC Statistical Update* or the table on the *Status of Creditor Participation Under Enhanced HIPC Initiative* in HIPC completion point reports to calculate representativeness) **Non-HIPC cases: one-off** (use information from the staff report closest to the Paris Club agreement)	**Every review (until arrears are resolved):** *Language for PN:* Staff will reach out to the relevant creditor EDs with a view to receiving consent to move ahead with the arrangement request/completion of the review despite [pre-HIPC Initiative arrears to non-Paris Club creditors] [arrears to "XXX"]. In case the consent is not received, staff will assess whether the three criteria under the policy on arrears to official bilateral creditors are satisfied, and will include this assessment in the staff report. The staff report will only be submitted to the Board if either the consent is in place or the three criteria are satisfied. Staff will convey to the authorities that as long as these arrears remain unresolved, every purchase or disbursement made available after the approval of the arrangement will be subject to a financing assurances review by the Board.	**Every review (until arrears are resolved):** *Language for SR (consent is secured):* Country X owes [pre-HIPC Initiative arrears to non-Paris Club creditors] [arrears to "XXX"] which have consented to the arrangement request/completion of the review. *Language for SR (consent is delayed):* Country X owes [pre-HIPC Initiative arrears to non-Paris Club creditors] [arrears to "XXX"], which have requested more time to consider consenting to Fund financing notwithstanding these arrears. An update will be circulated to the Executive Board not later than one week prior to the scheduled Board consideration. *Consent is not secured:* The assessment of the three criteria, in line with the arrears policy for official bilateral creditors, should be reflected in the staff report.** *Language for SR on the financing assurances review (for reviews after the approval of the arrangement):* Staff supports the completion of a financing assurance review on the basis that adequate safeguards remain in place for the further use of the Fund's resources in Country X's circumstances and that Country X's adjustment efforts have not been undermined by developments in debtor-creditor relations.

* "Best efforts" are determined on a case-by-case basis but would generally require the debtor to reach out to the creditor in writing to explain the terms required by the Paris Club Agreed Minute and offer to discuss terms within those parameters. The debtor would also be expected to respond to any inquiries or correspondence from the creditor.

** The following language should be in SRs:

Country X has outstanding arrears to [XXX], which has not provided consent to Fund financing notwithstanding these arrears. Staff assess that the Fund may provide financing in line with the policy on arrears to official bilateral creditors. In particular:

(i) Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies. [Support for this point.]

(ii) The debtor is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of the Fund-supported program. [Support for this point—procedural and substantive considerations.]

(iii) The decision to provide financing despite the arrears would not have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases. [Support for this point, taking into account size of contributions and track record.]

Appendix VIII. Information Sharing with Creditors in the Context of Sovereign Debt Restructurings[1]

Where a debt restructuring is needed to restore debt sustainability in a member country, the Fund can facilitate the sharing of information underlying the member country's program and staff's assessment of debt sustainability in order to inform creditors' decisions on the provision of financing assurances and the implementation of a debt restructuring consistent with program parameters. The extent of information sharing, with whom information may be shared, and the modalities of that disclosure will be determined by the specific context, weighing the considerations outlined below. This appendix sets out principles governing information sharing and provides guidance on what level of information can be shared during each stage of the restructuring process. Although information sharing is necessary, the draft debt sustainability analysis document itself cannot be shared and should be kept confidential until it is endorsed by the Executive Board and published. Staff must navigate this tension and, to the extent questions arise, should consult with LEG and SPR.

A. Introduction

1. The Fund conducts analyses of member countries' public debt and assesses whether members' policies are consistent with preserving public and external debt sustainability in the context of both Article IV Surveillance and use of Fund resources (UFR).[2] In the surveillance context, the Fund's analysis acts as an early warning system gauging debt-related risks. When a member is already experiencing debt-related stress, the analysis helps assess public debt sustainability. In UFR cases where policy adjustments, expected financing, and the clearance of arrears, if relevant, are not sufficient to preserve or restore debt sustainability—a requirement for Fund lending—the Fund's analysis will also generally set targets to guide any envisaged debt restructuring operation.

2. The Fund's debt sustainability analysis (DSA) is conducted under two frameworks. The Debt Sustainability Framework (LIC-DSF) for low-income countries is conducted jointly with the World Bank and is subject to special provisions for Fund-Bank information sharing and approval. The Sovereign Risk and Debt Sustainability Framework (SRDSF) for market-access countries is conducted solely by the Fund.

3. This appendix covers the modalities for sharing DSAs with creditors of a Fund member country. It mainly covers information sharing with creditors of a member country but also encourages the authorities to share information and hold discussions with civil society. It recognizes

[1] This appendix was prepared by a joint LEG/SPR team led by Stephanie Fontana-Raina consisting of Julianne Ams, Wolfgang Bergthaler, Martin Cerisola, Chanda DeLong, and Dalia Hakura and cleared by Yan Liu, Guillaume Chabert, and Mark Flanagan

[2] Debt is considered sustainable when a borrower is expected to be able to continue servicing its debts without a politically and economically unrealistic change in policies required to stabilize the debt-to-GDP ratio and deliver an acceptably low rollover risk. Annex I. The Fund's Policies on Debt Sustainability, Market Access, Financing Assurances, and External Arrears of Reviews of the Fund's Sovereign Arrears Policies and Perimeter, May 2022.

Fund staff's role in facilitating timely information sharing. Delays or shortfalls in information sharing can be counterproductive, leading to inefficient restructurings, protracted negotiations, and information asymmetry.

4. Both guiding principles and practical approaches are covered. The next section of this appendix outlines guiding principles applicable to information sharing. The following section provides guidance on the level of information sharing that is appropriate in the various stages of a debt restructuring. As a general point, to the extent the information requested by the creditors or in civil society consultations is the authorities' data or analysis, the authorities are welcome to share it.[3] However, if it is Fund staff's analysis as to program parameters that is requested, or if the request is directed at the Fund, the guidance in this appendix comes into play.

B. Guiding Principles

5. Staff's general practice should be to share the information necessary to inform the restructuring process. Information can be shared with creditors directly by the Fund (with the debtor authorities' consent and subject to confidentiality safeguards) or by the debtor authorities (with the Fund's consent).[4,5] Information sharing is useful to promote efficient restructurings, reduce the likelihood of protracted negotiations, and address information asymmetry. The DSA is prepared for Fund financing purposes and, as such, Fund staff does not "negotiate" the DSA with creditors or other third parties. Although staff may consider the views of creditors and civil society, and take them on board, it is ultimately the views of staff, with input from the authorities, that are dispositive for the purposes of preparing the DSA. Fund staff should be clear about these limits of the Fund staff's role when engaging and communicating with third parties at any stage of the restructuring process.

6. Confidentiality must be maintained. Steps may need to be taken by the debtor authorities or otherwise to maintain confidentiality. The information underlying the DSA produced by the Fund staff is confidential and sensitive and should only be shared subject to safeguards to ensure confidentiality, possibly including non-disclosure agreements.[6] Staff should also make clear, or

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[3] The authorities' data and analysis may not include staff's projections or assessments. If staff projections are embedded in information that the authorities would like to share with creditors or if it is unclear whether certain data or analysis are the Fund's or the authorities', both the Fund's and the authorities' consent is required, and the guidance set forth in this note should be applied.

[4] In line with long-standing practice, debtor members are informed when staff will engage with the Paris Club on their debt, and engagement is on a non-objection basis.

[5] Where information is shared by Fund staff with the authorities, the Fund's general information classification system would apply, with information falling into one of four categories: "available to the public," "Official Use Only," "Confidential," and "Strictly Confidential." The recipient is expected to treat the transmitted information in accordance with the security classification assigned by the Fund.

[6] For example, if a creditor committee has been formed, information underlying a DSA is generally shared pursuant to the existing non-disclosure agreement between the creditor committee's legal and financial advisors and the authorities' advisors. Separately, existing confidentiality protocols cover information shared at Paris Club meetings (or any representative creditor committee under the G20 Common framework).

ensure that the debtor authorities make clear, that this information is confidential, is not final and is subject to change, reflects only staff's views, and has not yet been approved by the Executive Board.

7. Staff cannot share the draft DSA document (or file) itself with creditors, unless first endorsed by the Fund's Executive Board. A DSA forms part of an Executive Board document and is, therefore, covered by the Transparency Policy and related guidance note.[7] The general rule is that country documents and parts thereof (in draft or final form) cannot be shared outside of the Fund prior to Executive Board issuance and publication. Most Executive Board documents, like DSAs, that are for Board consideration cannot be published before the Board date.[8] There are special rules governing sharing with the World Bank (discussed below).

C. Information Sharing: General Guidance

8. Judgment must generally be exercised by staff in the process of sharing information:

- **The modalities for providing information can vary.** Various methods may be possible and logical, depending on the nature of the recipient and the circumstances, including whether there are concerns about confidentiality. Oral presentations may be an important means during an early stage of engagement, e.g. with creditors. Information sharing could also be done through presentations to creditors at meetings or by sharing selected charts or tables.

- **The nature of the recipient matters.** Given the unique role of the debtor's financial and legal advisors for working purposes this may warrant more flexibility and a greater exchange of information. There is less room for judgment in sharing information with official creditor for a. Fund staff uses standard agreements with templates on balance of payments and financing gaps for sharing information with the Paris Club Secretariat when a Paris Club debt treatment is needed. The same practice has been followed with recent cases under the G20 Common Framework.

- **The sequencing of sharing information with private sector creditors and official sector creditors can also vary.** In past practice, information has frequently been shared first with official sector creditors before being shared with private sector creditors. However, there may be case-specific factors that weigh in favor of a different sequencing. Sharing the information in parallel with both official sector and private sector creditors can help to ensure equal information is provided to creditors, supporting high creditor participation through intercreditor equity. In addition, in cases where economic volatility is a significant issue, sharing the information with both private sector and official sector creditors at the same time may be

[7] See Transparency Policy, Decision No. 15420-(13/61), adopted June 24, 2013; and Updated Guidance Note on the Fund's Transparency Policy, April 2014.

[8] See paragraph 8 of the Updated Guidance Note on the Fund's Transparency Policy, April 2014. However, papers issued to the Executive Board, but for which the Board is not the primary intended audience, are not subject to Board approval for publication purposes. This includes technical assistance reports, which have their own publication regime in which publication is encourages. For more information on the technical note on debt sustainability provided to Argentina as technical assistance, see Annex 1.

needed to ensure all creditors have the same macroframework. Where a debtor chooses to sequence its negotiations to first restructure private sector debt or where the formation of an official sector creditor committee is delayed, it may be appropriate to share information first with private sector creditors to advance restructuring discussions and later, as necessary, with official sector creditors. Overall, information sharing should generally match the sequencing of the restructurings (i.e., share information with whichever creditor pool is being restructured first or ideally, all creditors at the same time if being restructured at the same time).

9. Sharing DSAs with the World Bank is subject to special rules:

- As LIC-DSFs are produced jointly, there is a special regime with well-documented rules of engagement and information sharing with World Bank staff. Fund staff are expected to engage with World Bank staff from the earlier stages of mission preparation, discussions, and analysis.[9,10]Thus, when sharing information related to a joint Fund-Bank LIC-DSFs, staff should recognize the joint role with the World Bank and consult first with World Bank staff.

- With respect to the SRDSF, sharing of country staff reports (including drafts) with World Bank staff prior to issuance to the Fund's Executive Board is permitted under the terms of the Bank-Fund Concordat. In most instances, mission chiefs retain the discretion as to whether specific material should be shared, regardless of classification.[11] In this case, the sharing regime with the World Bank creates no issue for sharing more broadly.

D. Information Sharing Through the Debt Restructuring Phases

10. This section outlines information sharing with creditors in each restructuring phase. The section provides a broad indication of the type of information that should typically be shared with creditors in each phase of a debt restructuring with program engagement. The broad guiding principle should be for Fund staff to provide creditors enough information, especially once specific and credible financing assurances are needed, to be able to produce debt restructuring scenarios that can meet the program financing parameters and debt sustainability targets.

Phase One: Pre-Announcement

11. Before the member country has announced its intention to seek a debt restructuring, the Fund should not share any non-public information with creditors. The decision on whether and when to seek a debt restructuring must be made by the debtor authorities. Until the authorities

[9] See Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries, December 2017.

[10] Separately from information sharing and engagement at the staff level, there is an expectation that all LIC-DSFs and SRDSFs for LICs will be submitted to both the Fund Executive Board and IDA's Executive Board at the same time. However, a Fund-management cleared LIC-DSF or SRDSF for a LIC may be shared with the World Bank's Executive Board if the World Bank requires it for its own operations for a country that is not expected to be discussed by the Fund's Executive Board in the next two months.

[11] See footnote 19 of Guidance Note on Information Sharing Between IMF and World Bank Staff, February 2022.

make such an announcement, Fund staff should not engage or share non-public information with creditors. In this stage, all information related to debt sustainability could be considered market sensitive. Published staff reports may be shared and referenced by staff. For countries that use the SRDSF, staff cannot share information related to the mechanical signal on debt sustainability with creditors that is not available in a published report.

Phase Two: Post-Announcement and Program Design, up to a Staff Level Agreement (SLA)

12. During the program design phase, creditors often have an interest in accessing the information underlying the Fund's debt sustainability analysis.

- First, the staff or the authorities may need to share information with one or more skeptical creditors to show why debt is unsustainable. This could include showing that debt or gross financing needs increase unsustainably over time or another stress metric reaches unsafe levels. In this process, such a scenario may be underpinned by staff's preliminary calibration of the program macroframework.

- Second, creditors will want to have an understanding about the key macro parameters under the potential Fund-supported program to further their understanding of program design. Staff can discuss its preliminary views, as embodied in the numbers presented, but should signal that they are mainly seeking to receive information from and hear the views of creditors at this stage. This can include views on the debtor country's macroeconomic variables, views on the pace and size of access to international capital markets, and confirmation of the characteristics of the debt held by creditors.

13. Staff may at some point consider sharing, with the debtor authorities' consent and subject to confidentiality safeguards, certain information on the financing envelope and key financing assumptions. Sharing this information or allowing the debtor's authorities to share this information with creditors subject to confidentiality safeguards may reduce the likelihood of protracted negotiations by enhancing the authorities' credibility that the debtor really does need the contribution that the program will potentially require in order to restore sustainability. Staff should only take this step once comfortable that the program macro-framework is close to being stabilized and should clearly signal that the information being shared may be subject to change as the SLA is finalized. Staff should also signal at this stage a willingness to receive information from and hear the views of creditors. The information could include:

- Macroeconomic projections, including growth and inflation rate projections, balance of payment forecasts, exchange rate projections, monetary and central bank accounts in detail. Staff should also be prepared to explain the assumptions/analysis that underpins the forecasts.

- Fiscal projections. Creditors will have an interest in assessing the authorities' "effort," and staff should be prepared to explain the assumptions/analysis that underpins the forecast and the rationale for the targets.

- The financing envelope and key financing assumptions, including disaggregated domestic and external financing, debt service projections, and public debt targets relating to Fund-supported programs (such as the parameters that ensure debt sustainability, the medium-term targets for the stock and liquidity indicators, and average and maximum gross financing needs).

Phase Three: Post SLA and Obtaining Assurances

14. After reaching SLA, a higher degree of information sharing will be necessary. Creditors may need this to agree to provide the necessary financing assurances and debt sustainability assurances or to conclude a restructuring agreement. This additional information that can be shared subject to confidentiality safeguards could include:

- Additional years of projections beyond what is usually included in the macroframework; and/or further disaggregation of data (e.g., for debt stock or debt service to individual creditors or between amortizations and interest payments).

- Public debt targets relating to the program (such as the parameters that ensure debt sustainability, the medium-term targets for the stock and liquidity indicators, and average and maximum gross financing needs).

- Modeling questions. Staff may answer modeling questions from official bilateral creditors, including, for example, on the range of magnitudes of the present value reduction that could deliver program targets and whether or not the program targets can be achieved without a nominal haircut. In responding to modeling questions, staff must make clear that the response is technical in nature and not a normative assessment from the Fund. This form of technical engagement should be pursued as early as possible as it could help accelerate the decision by the relevant official bilateral creditors to join an official creditor committee.

15. The higher degree of information sharing would carry over to a subsequent review under a Fund arrangement. If circumstances warrant, Fund staff may need to update the macroeconomic framework. In general, staff should not expect significant deviations in economic circumstances post-arrangement approval, and such technical macro updates are generally not expected to lead to changes in program parameters (e.g., DSA landing zones or financing gap). In the event of a significant change in the macro environment, changes to program parameters and assumptions may be necessary and should be reviewed by departments and approved by Fund management prior to being shared.

16. Sharing the more detailed information set out in paragraphs 14 and 15 should be discussed and agreed in advance with the authorities and must consider confidentiality safeguards (as set forth in paragraph 7 above). Examples of situations where such broader information sharing may be appropriate are outlined below:

- **With official bilateral creditors from whom financing assurances are required.**[12] Because official bilateral creditors elect Executive Directors that sit on the Fund's Executive Board, sharing a broader extent of data with them may be more appropriate than with others. Moreover, to the extent sharing is done in context of an established framework (e.g., the Paris Club or Common Framework), staff may feel more comfortable given the Fund's good offices role in the initiative and existing confidentiality understandings. To the extent the data are shared with the Paris Club, staff's default position should be to also share it with non-Paris Club official creditors (or non-CF official bilateral creditors) due to intercreditor equity considerations, so long as the debtor authorities' consent, confidentiality understandings are in place, and the creditor's claims are critical to restore debt sustainability.

- **With multilateral creditors.** Multilateral creditors include the World Bank Group (outside of the LIC-DSF context discussed above) and other international financial institutions (IFIs) such as Regional Financing Arrangements (RFAs). Where a multilateral creditor is being asked to provide the member with new money to fill financing gaps in the context of a Fund-supported program, it may need to review the data to better understand program parameters. Staff may feel more comfortable sharing a broader extent of data with these institutions due to long-standing relationships and confidentiality understandings. Nevertheless, it would still be important to seek the authorities' consent.

- **Circumstances where staff would share a broader extent of data with private sector creditors would be expected to be rarer.[13]** Although in some situations sharing a broader extent of data with official creditors can be justified due to the need to obtain specific and credible financing assurances, sharing this information with private sector creditors could put the Fund in the middle of deciding which private sector creditors to share information with and could raise confidentiality concerns. Staff would need to make a judgment that sharing the information is warranted given case-specific circumstances. Most importantly, the information may only be shared where the debtor authorities consent and staff is ensured that confidentiality will be maintained (e.g., share with the advisors only).

E. Other Information Sharing During a Debt Restructuring

a. Sharing of the Full DSA

17. In select and very rare instances, the debtor and creditor(s) may insist on the provision of the full DSA, which must be provided first to the Executive Board.

18. There are options for sharing the DSA with the Executive Board earlier in the process so that it can sooner be published and made available to creditors. While these modalities are

[12] See Section II of this Guidance Note.

[13] While staff is aware of one case where this was done (Chad 2021), this was due to very specific nature of creditor.

limited to specific circumstances, they could be explored where necessary. In each option, the DSA would need to first be issued to the Executive Board before publication:

- One modality to achieve this involves: (i) a request for DSA-related capacity development (CD) from the authorities; (ii) full discussion of the TA report with the authorities; and (iii) provision of the TA report to Executive Directors for information, with the authorities' consent to publish. This process was done for Argentina in 2020. In this modality, given that CD to Fund members is under Fund management authority, the DSA is provided to the Fund's Executive Board for information, rather than endorsement, under the CD dissemination policy. This modality is almost exclusively best applied in surveillance contexts, where policies are well-known.

- A second modality is a stand-alone DSA. There were several instances of standalone DSAs prepared for Greece in the UFR context in 2015 and then in the surveillance context in 2016 that the Executive Board agreed to publish. This can be applied in either a surveillance or program context.

- Executive Board approval in principle (AIP) of the program is a third option. Approval in principle of a Fund arrangement can be recommended to the Executive Board in limited circumstances where Fund staff and the member authorities have reached full agreement on the policies underlying a Fund-supported program and the only issue preventing arrangement approval is the need to catalyze agreement between the member and its creditors in respect of debt sustainability and/or financing assurances. Where the Executive Board approves an arrangement in principle, the member does not receive any financing under the arrangement until the Fund determines that debt sustainability is being restored upon receipt of financing assurances. The staff report including the DSA is presumed to be published under the transparency policy. This was done for Greece's SBA in 2017. This approach involves the most comprehensive availability of information (and there can be circumstances where the staff and authorities assess that comprehensive availability is desirable).

b. Information Sharing in the Surveillance Context

19. In a surveillance context, staff must be more circumspect in regard to sharing information with creditors:

- In the absence of a Fund-supported program and an MEFP, staff is generally not in a position to talk with precision about the authorities' intended policies and by extension their expected macroeconomic framework. Thus, staff are not in a position to discuss what would make the situation sustainable in terms of debt targets.

- Staff can talk about published surveillance work, covering staff's views about the macroeconomic outlook and debt sustainability, and the assumptions that have fed into this. Staff should be clear that these represent staff views.

- In the context of an ongoing Article IV consultation, staff should listen to creditors' views about the situation to inform staff's own judgment about the outlook and debt sustainability. Staff should be clear that it is ultimately the views of staff, taking into account feedback from the authorities, that are dispositive for the purposes of preparing the DSA.

20. The authorities may request that staff more formally provide its views to them, via technical assistance (i.e., the first modality for full DSA sharing, discussed above). As noted above, this would involve (i) a request for DSA-related CD from the authorities; (ii) full discussion of the CD report with the authorities; and (iii) provision of the CD report to the Fund's Executive Board for information, with the authorities' consent to publish. This process was done for Argentina in 2020. In this modality, given that CD to Fund members is under Fund management's authority, the DSA is provided to the Fund's Executive Board for information, rather than endorsement, under the CD dissemination policy.

c. Information Sharing with Civil Society

21. The authorities are encouraged to share information with civil society at each phase of the debt restructuring process and to listen to views, subject to the following considerations:

- Pre-debt restructuring announcement, the same considerations outlined in paragraph 12 for information sharing with creditors apply to information sharing with civil society. No non-public information should be shared.

- Post-debt restructuring announcement, for all phases, the authorities must proceed subject to confidentiality safeguards, as program discussions are confidential. Information that itself is confidential or market sensitive cannot be shared.

- Staff and the authorities have latitude to discuss any published information.

- In a surveillance context, the same considerations outlined in paragraph 18 for information sharing with creditors apply to information sharing with civil society.

Appendix IX. Example of a Standardized LIA Assessment

<table>
<tr><th colspan="2">LIA Criteria</th><th>Assessment</th></tr>
<tr><td colspan="2">Prompt Fund support is considered essential for the successful implementation of the member's adjustment program</td><td>Arcadia has experienced exceptional balance of payments pressures emanating from both the current and capital accounts. Notwithstanding progress achieved over the past year, official reserves remain very low covering only 45 percent of short-term debt and well below the 100 percent ARA benchmark of the Fund.</td></tr>
<tr><td colspan="2">The member is pursuing appropriate policies</td><td>Substantial fiscal consolidation since the beginning of 2016 has helped to reduce the primary deficit, and monetary policy has been tightened to control inflation and avoid an over-shooting of the exchange rate. The Arcadia authorities have committed to continue these policies (see Table X) and have set out an ambitious agenda of structural reforms (see Table X).</td></tr>
<tr><td rowspan="4">The member is making a good faith effort to reach a collaborative agreement with its creditors</td><td>Early dialogue with its creditors, which should continue until the restructuring is complete</td><td>An initial round of discussions was held with creditors in New York in early April 2024. The authorities have committed to meet on a quarterly basis until the debt restructuring is agreed.</td></tr>
<tr><td>Shares relevant information with all creditors on a timely basis</td><td>The authorities have shared information on the composition of the end-2023 debt stock, including the creditor composition, major subcategories of debt instruments (and information on the main financial terms), upcoming debt service and any collateral involved. The authorities have also provided macroeconomic projections for 2024-29, and the parameters of a debt operation to restore sustainability, including the perimeter of claims subject to such debt operations. The terms of the debt operation are consistent with the Fund-supported program.</td></tr>
<tr><td>Early opportunity to give input on the design of restructuring strategies and of individual instruments</td><td>Creditors have been able to submit their views on the appropriate design of the debt restructuring using the online platform introduced by the authorities in May.</td></tr>
<tr><td>Terms offered to the creditor is consistent with the parameters of the Fund- supported program.</td><td>See above.</td></tr>
<tr><td colspan="2">Is there a representative committee? Are the authorities negotiating with this body?</td><td>At present, the heterogeneous nature of Arcadia's creditors has meant that a representative committee has not been able to emerge. The authorities, have stated that they will negotiate with any group representing legitimate creditors.</td></tr>
</table>

Appendix X. State-Contingent Features in Restructurings

1. Sovereign state-contingent debt instruments (SCDIs) are instruments that bear contractual debt service obligations tied to a pre-defined state variable. This allows linking a sovereign's debt service obligations to its capacity to repay, which can improve risk sharing. SCDIs can take a number of forms but can broadly be divided into two categories: instruments featuring *continuous* adjustment of debt service payments, e.g. with payments tied to nominal GDP; and those involving *discrete* adjustment (e.g. the materialization of royalties from a recent oil discovery, or changes to the debt carrying capacity in the LIC DSF with substantial implications for the needed relief envelope). Another example of SCDIs involving discrete adjustments are instruments with an "extendible" design, where the maturity (or grace period) automatically extends in the face of a pre-defined shock. For example, the 2015 Grenada bond "hurricane clause" where a one-off debt service deferral is triggered by a hurricane of given intensity. Macro-linked bonds are instruments that become a bond in the future, with their nominal value and coupon stream being set based on the future value of certain macro variables.

2. SCDIs have been used in a few past debt restructurings, mainly in the form of upside instruments. Earlier examples include the GDP warrants issued to private creditors in Argentina (2005/10), Greece (2012) and Ukraine (2015), an upside instrument linked to Citizenship by Investment revenues in Grenada (2015), and "value recovery rights" linked to GDP, oil prices, and measures of the terms of trade in many of the Brady restructurings of the 1980s and 1990s. Recent examples in bond restructurings include a Value Recovery Instrument (VRI) linked to future oil revenues in Suriname (2023), future debt carrying capacity and exports in Zambia (2024) and a macro-linked bond in Ukraine (2024).

3. The economic case for SCDIs is strong, but risks require mitigation. By linking debt service to a measure of the sovereign's capacity to pay, SCDIs can increase fiscal space, and thus allow greater policy flexibility in bad states of the world. They can also broaden the sovereign's investor base, open opportunities for risk diversification for investors, and enhance the resilience of the international financial system. Should SCDI issuance rise to account for a large share of public debt, it could also significantly reduce the incidence and cost of sovereign debt crises. Some potential risks and complications include a high novelty and liquidity premium demanded by investors in the early stage of market development; design problems that lead to higher payments to creditors in scenarios where the debtor's repayment capacity is actually worse; adverse selection and moral hazard risks; undesirable pricing effects on conventional debt; pro-cyclical investor demand; migration of excessive risk to the private sector; and adverse political economy incentives. In practice, SCDIs tend to be heavily discounted by the market and their use tends to be limited to debt restructurings, where upside instruments provide a "sweetener" to help achieve a deal.[1]

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[1] One notable exception includes Climate Resilient Debt Clauses (CRDCs), which tend to be priced more favorably (though use outside of restructurings remains rare despite a concerted effort by the international community to facilitate their adoption).

4. The Fund is open to the use of SCDIs and does not get involved in their design in restructuring contexts but must evaluate whether their potential impact is consistent with program financing and debt sustainability. The design of SCDIs is an issue to be discussed by the authorities, their creditors, and respective legal and financial advisers. Fund staff should assume that legal advisors will mitigate litigation risk (while noting that staff should inquire about these risks since they are inherently higher given that the design might be novel). Staff does not take a stand on issues such as an SCDI discount relative to an actuarially fair value per se. Instead, staff's focus is on the SCDI's implications for debt sustainability and the objectives of the program.

5. Calculating the impact on debt sustainability and financing in the context of debt restructurings involves:

- **Establishing which creditors will require them.** SCDIs are normally requested by the private sector, meaning official creditors need to be consulted. A key question is whether they perceive CoT to be met ex ante, or whether they will assess it based on the ex-post payoffs (in which case there needs to be buffers in the sustainability assessment to accommodate clawbacks). In the absence of clear information from official creditors on CoT, staff should assume ex-post clawbacks in line with standard CoT clauses in official sector debt agreements.
- **Evaluating whether a restructuring proposal meets debt targets when and SCDI is part of the package.** Key to this evaluation is that the debt targets are met under the baseline scenario and that the probability of breaching the debt targets remains below benchmark levels. The techniques underpinning the SRDSF fanchart module can be used for this analysis. Staff should consult with SPR for modeling assistance.
- **Assessing whether risks are too large.** The analysis needs to take into account the SCDI pay-offs, the types and magnitude of shocks that the country is exposed to, and how these are correlated. The risk that large payments take place in scenarios where the debt targets are actually exceeded, as well as those where resources (e.g., reserves) are inadequate, and where the trigger does not perfectly correlate with capacity to pay should be assessed.

6. When the SCDI is not assessed to be in line with program parameters, staff should give feedback on the elements of SCDI design that are producing the problem. In this context:

- Normally, SCDIs that leave exposures uncapped or that would provide an upside for investors in states of the world where the country's repayment capacity is diminished, are not supported in Fund programs, given macroeconomic, political, and social risks.

- Simple trigger rules create the risk that temporary positive shocks lead to a permanently higher debt burden that will be difficult to carry once the shock fades. One solution is to consider more complex multi-layered rules and downside triggers, but that can exacerbate liquidity and pricing challenges.

- Instrument design can also focus on whether the mechanism is automatic; continuous or discrete; symmetric or asymmetric. The timing and definition of the trigger may also matter.

Appendix XI. Conditionality and Program Commitments in Fund Programs Involving Restructuring of Private Creditors

Country	IMF Program	Year	Restructuring Type	Form	Finalization/ Intermediate	Specific language	Notes
Zambia	ECF	2022	External, post-default	LOI/MEFP commitment	Finalization	We are committed to finalizing the MOU with official creditors by the time of the first program review, and **reaching agreements on comparable terms with other creditors** soon after, by the time of the second review at the latest.	
Suriname	EFF	2021	External, post-default	None	n/a		MEFP reports efforts to engage with private creditors in good faith, but does not provide a timeline for specific steps/finalization
Chad	ECF (EA)	2021	External, pre-emptive	LOI/MEFP commitment	Finalization	The authorities are committed to finalizing the MOUs with official creditors, and to **reaching an agreement on comparable terms with the largest private creditor**, by the time of the first review.	
Ecuador	EFF	2020	External, pre-emptive	None	n/a		Debt exchange completed prior to Staff Report issuance. Staff-level agreement was announced on 28 August, just before settlement deadline for the exchange.
Ecuador	RFI	2020	External, pre-emptive	LOI/MEFP commitment	Intermediate	to ensure that public debt remains on a sustainable path and rein in large and protracted financing gaps, we are in the process of implementing a comprehensive debt management plan. In particular, on Friday April 17 bondholders accepted a consent solicitation put forward by the Republic to defer all payments worth over USD 800 million, until August 15. During this grace period, **we will work with our advisors, to put forward a second consent solicitation to the market to restructure Ecuador´s outstanding debt.**	
Congo, Rep. of	ECF	2019-	External, post-default	LOI/MEFP commitment	Finalization	The authorities are committed to **completing the restructuring of external commercial debt and domestic debt** by the time of the first program review	MEFP commitment to agree restructuring by the first review
Mozambique	RFI	2019	External, post-default	None	n/a		No PAs, but agreement in principle with a group of Eurobond holders had been reached prior to the request. Restructuring discussions on another private loan were described as "almost finalized" in SR (this was never finalized, and Mozambique subsequently disputed the debt).
Barbados	EFF	2018	Domestic & external, latter post-default	Prior Action	Intermediate	Government to **launch exchange offer** for debt restructuring of the stock of central government domestic debt held by private creditors and eligible for debt restructuring consistent with EFF supported program objectives.	Conditionality did not cover external debt restructuring, but program request MEFP reported intention to table an exchange offer shortly

Country	IMF Program	Year	Restructuring Type	Form	Finalization/ Intermediate	Specific language	Notes
Mongoli a	EFF	2017	External, pre-emptive	None	n/a		Debt exchange completed prior to Staff Report issuance, mentioned as needed for financing assurances in staff level agreement.
Chad	ECF	2017	External, pre-emptive	LOI/MEFP commitmen t	n/a	The Government is determined to **reach the necessary restructuring** by the time of the first review of the requested program.	
Ukraine	EFF (EA)	2015	External, pre-emptive	Prior Action	Intermediate	Government will **hire financial and legal advisors** to facilitate consultations with holders of public sector debt with a view to improving medium-term debt sustainability	MEFP also reported intention to finalize the debt operation by the first review
Grenada	ECF	2014	Domestic & External, post default	Prior Action	Intermediate	Consistent **with the financing envelope of the program, satisfactory progress in negotiations with the creditors**, through: (i) initiating the negotiation phase of the restructuring with private and bilateral official creditors, (ii) seeking agreement on a debt restructuring consistent with closing the financing gap under the program and reducing debt to 60 percent of GDP by 2020; (iii) obtaining financing assurances from the Paris Club; and (iv) developing a credible timetable for advancing the restructuring discussions with private creditors through mid-2014.	
Cyprus	EFF	2013	Domestic, pre-emptive	Structural Benchmark	Finalization	**Roll over and extend the maturity** of at least €1 billion of domestic debt held by residents through a voluntary debt exchange covering maturities falling due in 2013-15 and roll over the €1.9 billion recapitalization bond of CPB by [First Review].	
Jamaica	EFF	2013	Domestic, pre-emptive	Prior Action	Finalization	Government to **complete a debt exchange** for domestic government bonds consistent with a reduction in the public debt-to-GDP ratio by 2020 equivalent to at least 8.5 percent of GDP.	
Greece	EFF (EA)	2012	Domestic & External, pre-emptive	Prior Action	Finalization	**Close a debt exchange** with private bond holders prior to the approval of the arrangement	Not in PA/SB table, but SR explicitly mentions as a PA
Greece	SBA (EA)	2011	Domestic & External, pre-emptive	LOI/MEFP commitmen t	n/a	To support these efforts with an appropriate level of financing, we have defined a strategy to achieve substantial and credible contributions from the private sector and official sectors. In this context we will aim to **finalize the relative contributions by private creditors and the official sector** by the time of the Fifth Review.	At the time of the 4th review, the need for PSI was made explicit, but SR only had an MEFP commitment to seek financing contributions from the private and official sectors (respective contributions yet to be specified), reflecting the still ongoing discussions within the official sector on the design and extent of the debt operation, against background of fears of contagion

Country	IMF Program	Year	Restructuring Type	Form	Finalization/ Intermediate	Specific language	Notes
St Kitts and Nevis	SBA (EA)	2011	External, post-default	Prior Action Prior Action Structural Benchmark	Intermediate	(1) Authorities **commit publicly** to undertake a debt restructuring (2) **Appointment of legal advisors** for the due diligence on the existing debt contracts (3) Make **substantial progress on the consultative phase** of restructuring with creditors (by first review).	
Jamaica	SBA	2010	Domestic, pre-emptive	Prior Action	Finalization	**Launch and complete debt exchange operation** that, in comparison to the existing securities, achieves an estimated saving of over 3 percent of GDP in FY2010/11 and a reduction in the amount of debt maturing during 2010-2012 by at least two thirds	
Seychelles	SBA	2008	External, post-default	None	n/a		MEFP reported recent hiring of advisors and intention to develop a comprehensive restructuring strategy, but no timeline was specified
Dominican Republic	SBA	2005	External, post-default	Prior Action Prior Action	Intermediate	(1) **Completion of consultative phase of rescheduling/restructuring** with private sector creditors (bondholders and commercial banks) (2) **Initiation of restructuring negotiations** with private external creditors on debt still in arrears, consistent with Fund's LIA policy	MEFP also reported the intention to launch a bond exchange offer in the first quarter of 2015 and complete commercial bank rescheduling by April
Argentina	SBA (EA)	2003(Dec)	External, post-default	Structural Benchmark	Intermediate	**Announce the basic features of a restructuring offer** in conjunction with the IMF/World Bank Annual Meetings in September, 2003. This announcement will clarify the scope of debt to be restructured, the treatment of initial claims and past due interest, and the general terms of the new debt instruments to be issued in the exchange.	
Argentina	SBA (EA)	2003(Jan)	External, post-default	Structural Benchmark	Intermediate	**Appointment of an external advisor** on public debt restructuring	MEFP also committed to preparatory steps, including preparing database on creditor structure and dialogue with creditors on procedural aspects
Uruguay	SBA (EA)	2003	External, pre-emptive	Prior Action	Intermediate	**Obtain and present to staff evidence of adequate financing assurances** to meet financing needs for the 2003 program	Supplementary LOI outlined broad features of the proposed exchange and specified intention to launch by April and conclude by early May
Argentina	SBA (EA)	2001	External and domestic, pre-emptive	None	n/a		Both 3rd and 4th Reviews mentioned authorities' intention to undertake voluntary reprofiling operations, but these were treated as an upside risk
Pakistan	EFF-ESAF	1999	External, pre-emptive	Prior Action	Intermediate	**Initiation of negotiations with commercial creditors** on debt restructuring.	
Russia	SBA	1999	External, post-default	None	n/a		MEFP reported that the government had been in close contact with creditors and intended to undertake negotiations in a cooperative manner

Country	IMF Program	Year	Restructuring Type	Form	Finalization/ Intermediate	Specific language	Notes
Russia	EFF	1998	External and domestic, pre-emptive	None	n/a		A debt exchange for domestic instruments (GKOs) had already been launched, with results to be announced on the day of the board meeting, but the program assumed modest take up
Ukraine	EFF	1998	External and domestic, pre-emptive	None	n/a		Supplemental LOI mentioned active discussions with external commercial banks, imminent offer for voluntary rescheduling of non-resident held T-bills, and an already initiated voluntary rescheduling of resident-held debt

Appendix XII. Template Communication to Creditor Executive Director

The following template may be used for staff's communications with creditor Executive Directors. However, it should be treated as flexible and should be modified to reflect the circumstances of the case.

1. **[Member]** owes **[amount]** in arrears to **[official bilateral creditor]**. Under Fund policy, staff assess that the underlying claim(s) are **[Direct Bilateral Claims / not Direct Bilateral Claims].** This assessment is based on **[list factors here—vote pooling with private sector, whether it is a secondary-market purchase, whether the entity is within the budgetary process (and, if not, indications that the entity was acting on behalf of the government: terms of the loan, mandate of the entity providing loan, whether the entity used the official or commercial window for the loan, whether there were public statements at the time of the loan, etc.)].**

2. ***For use where the claim is a Direct Bilateral Claim*:** Moreover, this is **[not]** related to Official Sector Involvement. In other words, the Fund-supported program does **[not]** provide for full payment of the claim.

3. Given this background, **[choose the relevant option below]**

- ***For use when the NTP policy applies (i.e., Direct Bilateral Claim not related to Official Sector Involvement):*** staff is requesting that you indicate whether your authorities will object to Fund financing under the non-toleration policy. Please respond by **[date, prior to issuance of SR]**; in case of no response, staff will proceed on the assumption that there is no objection. Under the non-toleration policy, acquiescence to Fund financing is not reflected in the staff report but is conveyed by your non-objection at the Board meeting.

- ***For use when the LIOA policy applies (i.e., Direct Bilateral Claim related to Official Sector Involvement):*** staff is requesting that you convey your authorities' explicit consent to proceeding with Fund financing despite the arrears. Please respond by **[date, prior to issuance of SR]**. Explicit consent will be recorded in the staff report. If your authorities need more time to consider whether to provide consent, please let us know, and this fact will be recorded in the staff report with a statement that staff will revert to the Board one week prior to the Board meeting with an update. Should your authorities not provide consent within four weeks, Strand 4 of the LIOA policy will be pursued.

- ***For use when the LIA policy applies (i.e., not Direct Bilateral Claim):*** the Lending into Arrears policy will apply to these arrears. No action is required from you or your authorities.