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For discussion

B.7 Arrears in International Investment Position

Prepared by the Balance of Payments Task Team (BPTT)

INTERNATIONAL MONETARY FUND

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This Guidance Note (GN) discusses several issues related to the treatment of arrears in the international accounts. The current presentation of the international investment position (IIP) lacks the indicator related to arrears as a separate item, thus, making it difficult to interpret IIP statistics in terms of “asset quality” and does not provide information on the share of such instruments in the country’s position. The GN discusses these issues and proposes alternatives to be considered, some of which may require the update of Balance of Payments and International Investment Position Manual, sixth edition. The GN does not discuss the solutions for the presented methodological problems, related to the accounting for arrears, as each problem is not enough significant for the whole IIP, but together they require more attention in the new manual.

SECTION I: THE ISSUE

BACKGROUND

1. Modern financial systems are quite dynamic and evolve rapidly in multiple directions, sometimes leading to turbulence on financial markets and sharp increases in insolvencies of financial market participants. As financial and real economic sectors are highly interconnected, adverse effects caused by fluctuations on financial markets influence also the soundness of the real sector entities. One of the indicators, highlighting the potential problems in the state of a country’s financial system, is the amount of arrears as well as their dynamics, which can be one of the reasons for a loss of the country’s debt stability and all concerns connected with this phenomenon. A significant increase in arrears may be a harbinger of an impending economic crisis, for example, as happened in 2008—the subprime debt crisis. Indeed, the lack of proper information about the debt and the absence of a timely response from the authorities led to dire consequences. The crises of the 90s were also largely debt-driven.
2. At the same time, for economies external debt is among the most important factors to monitor. The huge amount of debt has been accumulated in the global economic system, while the pandemic has only exacerbated this crisis. And while developed countries can accumulate debt for some time without risking a collapse of their financial system, emerging countries find themselves face to face with impending consequences.
3. The additional granularity of data on arrears by institutional sectors, financial instruments, and currency composition is important for the users of external sector statistics.
4. The breakdown of arrears by institutional sector in relation to a country’s liabilities in the form of debt provides the information about the risk concentration centers which may cause debt instability. In particular, the level of the arrears related to government debt reveals a partial loss of the government’s ability to service its external debt as well as an additional burden on the government finance. At the same time, the arrears under direct investment may not lead to an increase in the risk for a country’s financial stability as these cases can be managed by the parent company without litigation and related negative consequences for the borrower.

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5. The data on the arrears broken down by financial instruments can also be valuable for analytical purposes. In the practice of many countries there are rigid restrictions (debt covenants) for some types of debt instruments, which may in particular imply an immediate repayment of the debt instrument issued by a borrower if there are arrears on other financial instruments, related to the borrower. The rapid dynamics of the amount of such early redemptions may cause a spillover effect in the form of cross-defaults for a significant number of top borrowers, thus, undermining the country's financial stability.

6. The currency composition of arrears can provide an estimate for the level of the risk related to the exceptional borrowing of a country on foreign capital markets to meet its obligations to repay debt liabilities denominated in foreign currencies, while a part of these outstanding liabilities in the national currency can be redeemed, in particular, by an additional currency issuance by the central bank. Therefore, the debt liabilities denominated in different currencies may have various effects on the financial soundness of a country.

7. Informing the authorities and society on increasing trends in arrears in a timely and high-quality manner could prompt intervention which can help in reducing some of the negative consequences of such phenomena. The lack of the information on arrears, in particular on the currency composition of arrears together with the types of instruments, for which arrears arise, and the absence of the relevant actions from the authorities can make it impossible to prepare appropriate economic policy measures. It is not always possible to prevent a crisis, but it seems necessary to make life easier for economic agents with various support programs. Availability of good quality data on the current economic situation can help in the elaboration of the appropriate policy measures. Arrears already present evidence of serious liquidity problems in short term perspective and problems with solvency in the longer term. In this respect, arrears are one of the most important indicators that should be reflected in an explicit form in external sector statistics. Bridging this data gap should be among top priorities for statisticians.

8. Arrears are defined as amounts that are both unpaid and past the due date for payment (*Balance of Payments and International Investment Position Manual*, sixth edition (*BPM6*), paragraph 5.99). Arrears can arise both through the late payment of principal and interest on debt instruments (which are recorded in the original debt instrument) as well as through late payments for non-debt instruments and other transactions (which are recorded in a new debt instrument) (*2013 External Debt Statistics: Guide for Compilers and Users (2013 EDS)*, Appendix 7, paragraph 3).

9. Data on arrears are important in their own right, and thus should be presented as supplementary items, where significant (*BPM6*, paragraph 3.57). Within the *2013 EDS* framework, total value of arrears is separately identified by sectors in memorandum items to Table 4.1 (*2013 EDS*, paragraph 4.4). The memorandum table (Table 4.2) provides information on external debt arrears of the total economy. It presents arrears at nominal value by sector detailed by principal and interest (*2013 EDS*, paragraphs 4.9–4.10). Total value of arrears and debt securities by sector are also separately identified in memorandum items to Table 5.1 Public and Publicly Guaranteed External Debt and Private Sector External Debt Not Publicly (*2013 EDS*, paragraph 5.8).

10. The reasons, presented in paragraphs 1–7, indicate the need for more breakdowns (such as breakdowns by financial instrument or by currency) of data on arrears as well as for separate presentation of arrears on assets. These suggestions are reflected in Alternatives II and III. Moreover, in the EU there is a project, called “AnaCredit”, which is focused on the collection of information on

individual bank loans and contains the information on arrears among other attributes of a loan (*AnaCredit Reporting Manual Part II—Datasets and Data Attributes, second edition*).

11. Arrears can arise for different reasons, including inability of monetary authorities to provide foreign exchange or disagreement between creditor and the debtor on the amounts due, so that arrears can be classified by type (*2013 EDS*, Appendix 7, paragraph 5). Although it is useful to identify some commonly important arrears (such as arrears on public and publicly guaranteed debt), flexibility is needed in determining which items of arrears are important to disseminate, depending on each economy's circumstances (*BPM6*, paragraph 3.57).

12. Within the framework of the *Balance of Payments Manual*, fifth edition (*BPM5*), arrears were reclassified from the original debt instrument (asset or liability) to other assets or other liabilities, short-term (*BPM5*, paragraph 458). In particular, arrears of amortization and interest were recorded in accordance with the accrual principle as if paid and a counter-entry was made to reflect the new liability (*BPM5*, paragraph 458). In the standard presentation of the balance of payments, arrears of amortization and interest were recorded as if the amounts had been paid on schedule (*BPM5*, paragraph 528). In the analytic presentation, only payments of arrears resulting from the balance of payments difficulties were included under exceptional financing (*BPM5*, paragraph 529).

13. The principles for recording arrears have been revised in *BPM6*. This was done in order to harmonize the recording of arrears in different macroeconomic statistical systems. Before the revision of *BPM5*, there were two bases of recording debt repayment, namely, the due-for-payment basis and the accrual basis. The due-for-payment basis was applied in the relevant statistical publications: *BPM5* (paragraphs 123 and 528), the *2001 Government Finance Statistics Manual* (paragraph 9.19) and the *2003 EDS* (paragraphs 2.29 and 3.36). If a debt liability was overdue under the due-for-payment basis, transactions were recorded as if the debt liability was repaid and then replaced with a new short-term obligation. This conditional calculation of transactions gave the impression that the debtor is able to repay the debt and take out a new loan. The second basis for recording of arrears was the accrual basis, which was consistent with the *1993 System of National Accounts* (paragraphs 3.94 and 11.101) and the *Monetary and Financial Statistics Manual & Compilation Guide* (paragraphs 179, 225, and 238).

14. According to the accrual basis of recording, repayment of debt is recorded at the time of liquidation of a debt liability (for example, when it is repaid, reissued or forgiven by the lender). With this approach, arrears continue to be recorded with the same instrument until it is liquidated. The advantage of switching to *BPM6* in terms of arrears is that the new approach (the accrual basis) avoids complex and artificial imputation, since there is no need to record any transactions related to overdue debt.

15. When switching to *BPM6*, it was noted that it was necessary to allocate arrears for each instrument separately: "In order to identify items in arrears in the IIP [international investment position], either a separate subheading can be added for each instrument having arrears or arrears can be shown as memorandum items" (Revision of the *BPM5* (Annotated Outline), paragraph 3.11). In the documents prepared by Balance of Payments Technical Experts Group (BOPTTEG), it was proposed to allocate overdue debts for various types of instruments in terms of balance of payments operations for exclusive financing for those countries that do not form an IIP. (Issues Paper #3. Application of Accrual Principles to Debt Arrears).

16. After the adoption of *BPM6*, arrears were reflected in the exceptional financing indicators as memorandum items in balance of payments. Exceptional financing brings together financial arrangements made by the authorities (or by other sectors fostered by authorities) of an economy to meet balance of payments needs (*BPM6*, paragraph A1.1). Other arrears that are not related to exceptional financing are not indicated/reported separately. Arrears not related to exceptional financing may be recorded as a supplementary category in total and under the specific financial asset or liability class affected (*BPM6*, paragraph 5.101). According to *BPM6*, paragraph A1.22, arrears, which are related to exceptional financing, are included in the analytical presentation because this presentation is focused on the actions of the monetary authorities to meet balance of payments needs and accumulating arrears is an action the monetary authorities can take for this purpose. Arrears in the current period resulting from balance of payments difficulties due to the inability of the authorities to provide foreign exchange are recorded as an accumulation of arrears within exceptional financing.

17. However, arrears are not presented as a separate item in standard components of the IIP. Therefore, this template lacks the analytical value from the financial stability perspective, in particular, external users are unable to estimate the exact amount of arrears.

18. Potential problems related to the current reporting of the amount of arrears can be in particular revealed by poor submission within the current statistical standards of external debt statistics (EDS): data on arrears of only one-third of countries that contributed to EDS data are available in the Quarterly External Debt Statistics (QEDS) Database.

19. Concerns/shortcomings of the current treatment, including special cases:

- According to the definition of arrears, they should be recorded at nominal value (*BPM6*, paragraph 5.99). In addition, arrears should be recorded at nominal value, as it is a measure of the overdue amount that the debtor owes to the creditor, according to the terms of the contract between two parties (2013 EDS, Appendix 7, paragraph 8). An issue arises when arrears are shown as a part of the appropriate instrument, which is vital for both assets and liabilities. Such presentation makes it impossible to estimate liquidity of that instrument, its market value, since nominal price does not represent the current economic situation. What is more this approach leads to an overstatement of assets as the market value of an insolvent instrument falls sharply, but the nominal price remains the same.
- The current treatment of arrears for debt securities, which are past due and are a part of portfolio investment (*BPM6*, paragraph 3.56), implies their inclusion in the total stock for this functional category but there is no methodological justification in *BPM6* or practical evidence for such treatment, given the lack of liquidity of such instruments. Therefore, these securities require some kind of reclassification but there is no guidance in the current manuals for this issue.
- Arrears, being recorded as a part of long-term instruments, lack the economic rationale as these instruments being past due should have already been redeemed. Therefore, the arrears on such instruments should be reclassified to short-term instruments.

20. The issues mentioned below require methodological guidance as there are no recommendations on them in the current versions of manuals on balance of payments, IIP, and external debt statistics.

- The current definition of arrears includes specific types of arrears that can be identified separately (2013 EDS, Appendix 7, paragraph 5). In particular, a special type of arrears appears due to the technical failures in settlement and payment systems used by counterparties to complete a transaction. In the practice of financial and economic relations with non-residents, the debt liabilities of one of the parties can be redeemed with a delay of 1–2 days due to such technical reasons. Significant amount of such arrears can arise without real economic reasons for insolvency; therefore, this type of arrears might be excluded from arrears. Another type of arrears is related to the situation: when in the context of global economic and political instabilities there may be cases of cancellation or postponement of the incoming payment by a counterparty bank, which do not characterize the solvency of the debtor, so that kind of arrears should also be excluded from arrears. At the same time, for these cases paragraph 8.59 (BPM6) states that “In addition to exceptional financing, other arrears indicate potential, or actual problems servicing debt, and so may be shown as supplementary items”.
- Paragraph 5.82 (BPM6) states that “Once a financial derivative reaches its settlement date, any unpaid overdue amount is classified as accounts receivable/payable, as its value is fixed, and thus the nature of the claim becomes debt.” At the same time, in the practice of statistical reporting there is a lack of clarity regarding the classification of unpaid option premium or overdue payments owed by one party to another party on periodic settlement dates
- In the situation when a bank issues a bill and then sells it to a nonresident, who does not apply to the bank for the repayment of this bill at maturity, such a liability should not be treated as arrears, since the bank is ready to meet its liability. At the same time, paragraph 2.32 (2013 EDS) states that “In some instances, arrears arise for operational reasons rather than from a reluctance or inability to pay. Nonetheless, in principle such arrears, when outstanding at the reference date, should be reported as arrears.” In the balance of payments, such situation is shown as a redemption of the bill and the corresponding increase in accounts payable.
- In practice, compilers encounter the cases (let’s consider this case from the creditor side), when a bank owns a foreign debt security, being a bondholder, and at maturity the issuer of this security meets its debt liabilities, but the settlement depository delays the transfer of funds to the bondholder. Therefore, the bondholder does not receive funds in accordance with the terms stipulated in the prospectus, but the issuer’s liability should not be considered as arrears as the issuer has already met its obligations which is opposite to the treatment, stated in paragraph 2.32 (2013 EDS). In the balance of payments, it is shown as a redemption of a debt security owned by a resident investor accompanied by an increase of the amount related to the redeemed bonds in other accounts receivable, related to the bondholder’s claim on the funds delayed by the depository.

ISSUES FOR DISCUSSION

21. **Alternative I considers keeping the methodological and presentational status quo**, thus avoiding overburdening the current template with information, that wouldn’t reflect users’ needs in countries with low evidence of arrears.

22. **Alternative II proposes to separately identify arrears for each debt instrument in the IIP via “of which” items by providing memorandum information for stocks on accumulated arrears.** This alternative would require changes in the core IIP framework and additional methodological guidance in the updated manual but only for the presentation of accumulated arrears as a sub-item in IIP. Despite some inconvenience for external users related to additional data treatment and a need for the aggregation of data on arrears, for instance, for all sectors to ensure further analysis, this approach may be attractive due to the following reasons:

- a. the ability of the users of the external sector statistics to evaluate the amount of arrears and its share in the IIP;
- b. the dissemination of memorandum items on accumulated arrears will provide the users of external sector statistics with the additional analytical information on arrears and enable them to compare this information with other data sources related to the topic;
- c. the provision of additional granularity and an opportunity to analyze arrears separately for each debt item.

23. **Alternative III implies supplementary presentations of arrears in integrated format (similar to the integrated IIP format), that would include flows, revaluation, and other changes, in breakdowns presented in Annex II.** This alternative provides a unique opportunity for an in-depth analysis of arrears and the reasons behind them. This approach allows us to expand the framework of the information provided, including by compilation of arrears data by foreign and national currencies, but requires considerable resources dedicated to data compilation and dissemination. In addition, the alternative demands the consistent methodological guidance on the integrated IIP for arrears, which means that all parts of such presentation (stocks, flows, revaluation, and other changes) have to be carefully described in the updated manual. Alternative III does not imply additional presentation of data with geographical breakdown. Arrears data is shown as a whole in relation to the rest of the world.

24. Alternatives II and III do not contradict the Guidance Note (GN) F8 “Valuation of debt securities at both market and nominal value”. Moreover, we suppose that they contribute to the topic by allowing the users of external sector statistics to separately analyze the nominal value of debt instruments and the amount of arrears related to them.

25. In relation to the issues, highlighted in paragraphs 19–20, both Alternatives II and III:

- a. allow users to estimate the liquidity of an IIP item by subtracting the amount of arrears from the total of the item;
- b. enable users to estimate more accurately the amount of long-term instruments;
- c. contribute to the additional methodological guidance in the updated manual, which is supposed to remove at least some questions raised in paragraph 20.

SECTION II: OUTCOMES

RECOMMENDATIONS

26. **Consultations within the Balance of Payments Task Team (BPTT) showed that the views of the members were somewhat split with half of the members supporting Alternative II and the others expressing preference for maintaining the status quo (i.e., Alternative I).**

27. **Those who supported no change to the current framework (Alternative I) consider that the data on arrears are mostly relevant for liabilities.** As the 2013 EDS appropriately covers these data (e.g., Table 4.1), the need to include them in IIP is questioned. Although one member acknowledged the analytical usefulness of arrears on asset side, the status quo was preferred on the premise that other alternatives would impose additional burden and most of the countries may not be able to provide such data. Further, data on arrears may not be significant for all the countries.

28. **Members supporting Alternative II (i.e., separately identify arrears for each debt instrument in the IIP via “of which” items through memorandum information in IIP) noted that it enables the users of external sector statistics to analyze IIP positions in arrears for each debt instrument.** This allows to combine the data on arrears in different analytical breakdowns and get an economic intuition of the current insolvency risks related to particular sectors of the country under consideration. While this alternative requires a revision of the data collection systems for various sectors and instruments, and imposes burden on the resources, the benefits of more detailed arrears data will override the costs of its compilation. There were also suggestions to collect arrears of public and private sectors, if possible.

29. **Given that the views of BPTT members for Alternatives I and II were split, the drafting team recommends posting the current version of the GN for public consultation.** Following this, a decision on the recommended alternative for discussion in the IMF’s Committee on Balance of Payments Statistics meeting will be based on the updated GN, incorporating inputs from such consultation. However, it is noted that in the absence of a majority opinion, the fallback solution of no change in the current standards would apply.

REJECTED ALTERNATIVES

30. **Although Alternative III requires only supplementary presentation of arrears data, this alternative received no support, apparently due to the burden associated with the compilation of detailed tables proposed under this alternative.** Alternative III is rejected as compilation costs will exceed potential analytical value and a supplementary status of the presentation may discourage compilers from prompt actions to disseminate such data. Moreover, Alternative III requires that significant additional guidance on the presentation of arrears in the IIP (in comparison with extra guidance in case of Alternative II) should be included in the updated IMF’s *Balance of Payments and International Investment Position Manual*. In addition, not all countries disseminate the integrated IIP, thus, they will be unable to compile such supplementary presentations on arrears. Consequently, this alternative does not meet the criteria of cost-benefit principle and should be rejected.

31. There is a strong need for coordination of the data collection for arrears under any alternative, as data sharing is one of the cornerstones for timely, consistent, and comprehensive statistical data for almost each phenomenon in the modern economy. In particular, such data sharing will enhance the

consistent understanding by compilers of the financial conditions of the companies, which encounter problems with arrears related to their debt relations with nonresident counterparties.

Questions for Discussion:

1. *Does the Committee agree that arrears are important from the perspective of external sector statistics and its users, and therefore require separate treatment in the international accounts?*
2. *Taking into consideration the strengths and weaknesses of each proposed alternative, which of them does the Committee support?*
3. *Does the Committee have proposals related to the additional breakdowns of arrears, which are not mentioned in the suggested alternatives?*
4. *Does the Committee suppose that methodological concerns and issues raised in this GN require the elaboration of a separate GN to address them?*

Annex I. Supplementary Information

REFERENCES

International Monetary Fund (2008), *Balance of Payments and International Investment Position Manual, sixth edition*, Washington, D.C.

International Monetary Fund (1993), *Balance of Payments Manual, fifth edition*, Washington, D.C.

International Monetary Fund (2014), *External Debt Statistics: Guide for Compilers and Users*, Washington, D.C.

International Monetary Fund (2004), Revision of the *Balance of Payments Manual, fifth edition* (Annotated Outline)

International Monetary Fund (2004), Issues Paper #3. Application of Accrual Principles to Debt Arrears

Annex II. Supplementary Presentations of Arrears for Alternative III²

Table 1. Proposed Breakdown of Arrears by Institutional Sectors

	Position as of	Changes in Position Reflecting:			Position as of
		Transactions	Valuation Changes	Other Changes	
Assets					
Central Bank					
Deposit-Taking Corporations, Except Central Bank					
General Government					
Other Sectors					
Other Financial Corporations					
Nonfinancial Corporations, Households, and NPISHS					
Liabilities					
Central Bank					
Deposit-Taking Corporations, Except Central Bank					
General Government					
Other Sectors					
Other Financial Corporations					
Nonfinancial Corporations, Households, and NPISHS					

² The supplementary data on arrears are not limited by exceptional financing.

Table 2. Proposed Breakdown of Arrears by Type of Instrument

	Position as of	Changes in Position Reflecting:			Position as of
		Transactions	Valuation Changes	Other Changes	
Assets					
Debt Securities					
Financial Derivatives					
Loans					
Deposits					
Trade Credit and Advances					
Other Accounts Receivable					
Liabilities					
Debt Securities					
Financial Derivatives					
Loans					
Deposits					
Trade Credit and Advances					
Other Accounts Payable					

Table 3. Proposed Breakdown of Arrears by Currency

	Position as of	Changes in Position Reflecting:			Position as of
		Transactions	Valuation Changes	Other Changes	
Assets					
Domestic Currency					
Foreign Currency					
Liabilities					
Domestic Currency					
Foreign Currency					