8. Debt Reorganization

Introduction

8.1 Debt-reorganization transactions are a feature of external debt activity. Economies sometimes face difficulties in meeting their external debt obligations, or debtors may want to change the repayment profile of their external obligations for different reasons, including reducing the risk of future payment difficulties or reducing the cost of borrowing. In this context, they may undertake debt restructuring and debt conversions. This chapter defines debt reorganization, discusses the various types of debt-reorganization operations, and provides guidance on how they affect the measurement of the gross external debt position. Further, this chapter defines debt relief and recommends the measurement and presentation of statistics on debt reduction, which is also defined.

8.2 Reference is made in the chapter to the recording of debt-reorganization transactions in the measured flow data of the balance of payments, the OECD's Development Assistance Committee (DAC) system, and the World Bank's Debtor Reporting System (DRS). Full details of such recording approaches are set out in *BPM5* (IMF, 1993), the OECD's *Handbook for Reporting Debt Reorganization on the DAC Questionnaire* (OECD, 1999), and the *Debtor Reporting System Manual* (World Bank, 2000).[1]

Definitions

8.3 *Debt reorganization* is defined as bilateral arrangements involving both the creditor and the debtor that alter the terms established for the servicing of a debt. Types of debt reorganization include debt rescheduling, refinancing, forgiveness, conversion, and prepayments. A creditor can also reduce debt through debt write-offs—a unilateral action that arises, for instance, when the creditor regards a claim as unrecoverable, perhaps because of bankruptcy of the debtor, and so no longer carries it on its books. This is not debt reorganization as defined in the *Guide* because it does not involve a bilateral arrangement. Similarly, a failure by a debtor economy to honor its debt obligations (default, moratorium, etc.) is not debt reorganization.

8.4 Generally, debt reorganization is undertaken to provide some *debt relief* to the debtor and can address liquidity and/or sustainability problems arising from future and current payment obligations. *Debt relief* results where there is (1) a reduction in the present value of these debt-service obligations; and/or (2) a deferral of the payments due, thus providing smaller near-term debt-service obligations (this can be measured, in most cases, by an increase in the duration of these obligations; that is, payments become weighted more toward the latter part of the debt instrument's life). However, if debt reorganization results in changes in present value and duration that are countervailing in their impact on the debt burden, then there is no debt relief, unless the net impact is significant, such as could occur if there was a deep reduction in present value (together with small decrease in duration) or a sharp increase in duration (together with a small increase in present value).

8.5 *Debt reduction* is defined as the reduction in the nominal value of external debt arising from a debt-reorganization arrangement, excluding any payments of economic value made by the debtor to the creditor as part of the arrangement. This is the definition to be used for compiling data to be presented in Table 8.1—debt reduction arising from debt reorganization. *Debt reduction in present value terms* is defined as the reduction in the present value of debt-service obligations arising from a debt reorganization, as calculated by discounting the projected future payments of interest and principal both before

[1] See also Chapter 17.

Table 8.1. Nominal Value Debt Reduction Arising from Debt Reorganizations

Debtor
Public sector
Of which: Multilateral
Official bilateral
Commercial bank[1]
Bonds and notes
Publicly guaranteed private debt
Of which: Multilateral
Official bilateral
Commercial bank[1]
Bonds and notes
Other private debt
Of which: Multilateral
Official bilateral
Commercial bank[1]
Bonds and notes
Of which:
Rescheduled and refinanced
Public and publicly guaranteed debt
Other private debt
Forgiven
Public and publicly guaranteed debt
Other private debt
Debt conversions and prepayments
Public and publicly guaranteed debt
Other private debt

[1]Excluding bonds and notes.

and after the reorganization at a common interest rate and comparing the difference. To illustrate the difference between *debt reduction* and *debt reduction in present value terms,* if the contractual rate of interest is reduced with no impact on the nominal value of external debt, no *debt reduction* is recorded but there is *debt reduction in present-value terms*.

8.6 *Debt swaps* are exchanges of debt, such as loans or securities, for a new debt contract (debt-to-debt swaps), or exchanges of debt-for-equity, debt-for-exports, or debt-for-domestic currency, such as to be used for projects in the debtor country (also known as *debt conversion*).[2] This definition is intended to include debt-for-development swaps where economic value is provided by the debtor to the creditor for use in development projects in the debtor's economy.

[2]A debt swap should be distinguished from a financial derivative swap. The financial derivative swap involves two parties agreeing to swap future cash flows, while a debt swap involves the exchange of the debt instrument itself for economic value.

Types of Debt Reorganization

8.7 The three main types of debt reorganization are:

- A change in the terms and conditions of the amount owed, which may result, or not, in a reduction in burden in present-value terms. These transactions are usually described as *debt rescheduling*. They are also sometimes referred to as refinancing or as debt exchanges. Included are transactions that change the type of debt instrument owed—for example, loan for bond swaps—but not debt-forgiveness transactions.
- A reduction in the amount of, or the extinguishing of, a debt obligation by the creditor via a contractual arrangement with the debtor. This is *debt forgiveness* as described in *BPM5* and the DRS and is also classified as debt forgiveness in the DAC system if there is a development/welfare motive.
- The creditor exchanges the debt claim for something of economic value other than another debt claim on the same debtor. This includes *debt conversion*, such as debt-for-equity swaps, debt-for-real-estate swaps, and debt-for-nature swaps,[3] and debt prepayment or buybacks for cash.

8.8 Debt-reorganization packages may involve more than one type; for example, most debt-reorganization packages involving debt forgiveness also result in a rescheduling of the part of the debt that is not forgiven or canceled.

8.9 For clarification purposes, in discussing the statistical treatment of debt reorganization, each of the three types of debt reorganization is considered separately. This has a number of advantages: each type of debt reorganization raises different statistical issues, hence encouraging a type-by-type approach; present international statistical guidelines, on which the guidelines in this chapter are based, are more advanced for some types of debt reorganization than for others; and there is interest in the different types of debt reorganization, and so there is an analytical benefit, where possible, in separately measuring and reporting any debt reduction resulting from their application.

[3]Some agreements described as debt swaps are equivalent to debt forgiveness from the creditor together with a commitment from the debtor country to undertake a number of development, environmental, etc., expenses. These transactions should be considered under the second type of debt reorganization, as counterpart funds are not provided to the creditor.

Debt Rescheduling

8.10 Rescheduling refers to the formal deferment of debt-service payments and the application of new and extended maturities to the deferred amount. This may be conducted: (1) through the exchange of an existing debt instrument for a new one, as in refinancing or debt exchanges; or (2) through a change of the terms and conditions of the existing contracts (this is often simply referred to as rescheduling, as opposed to refinancing). Rescheduling may or may not result in a reduction in the present value of debt, as calculated by discounting the old and new payment schedule by a common interest rate.

8.11 Refinancing of a debt liability involves the replacement of an existing debt instrument or instruments, including arrears, with a new debt instrument or instruments. For instance, the public sector may convert various export credit debt it is owed into a single loan. Refinancing may involve the exchange of one type of debt instrument, such as a loan, for another, such as a bond. Some debt-refinancing arrangements feature new money facilities (see below, paragraph 8.51). Also, refinancing can be said to have taken place when countries with private sector bond creditors exchange existing bonds for new bonds through exchange offers (rather than a change in terms and conditions).

8.12 Rescheduling can be characterized as flow or stock rescheduling. A flow rescheduling typically refers to a rescheduling of specified debt service falling due during a certain period and, in some cases, of specified arrears outstanding at the beginning of that period. A stock rescheduling involves principal payments that are not yet due, and arrears, if any, and like a flow rescheduling, can include both an element of debt forgiveness and a rescheduling of the amounts not reduced.

Recommended treatment

External debt position

8.13 Any agreed change in the terms of a debt instrument is to be recorded as the creation of a new debt instrument, with the original debt extinguished at the time both parties record the change in terms in their books. Whether the gross external debt position increases, decreases, or remains unchanged depends on whether the value of the new instrument(s) is respectively greater than, smaller than, or the same as the original debts being replaced—this is the case regardless of the valuation method employed to measure external debt instruments.[4] In other words, both before and after a debt rescheduling, the value of the gross external debt position is simply determined by the value of outstanding external debt liabilities of residents owed to nonresidents at the reference date.

8.14 As explained in Chapter 2, and as the examples in that chapter illustrated, the stock of external debt at any moment in time can be calculated by discounting future payments at a specified rate of interest. This interest rate can be the contractual rate (for nominal value), or a market rate for the specific borrower (for market value), or another rate. Using these different rates to discount payments will provide different position data for the same payment schedule. Debt reduction in present-value terms arising from rescheduling might be calculated using any of these rates—in the HIPC Initiative, a market-based rate is used.

8.15 If, as part of official and private debt-reduction packages, loans denominated in foreign currency are swapped for debt securities denominated in the domestic currency, the difference between the value of the loan and the value of the debt security in the domestic currency will be reflected in the gross external debt position. The extinguishment of the old debt liability, the loan, results in a decrease in the value of *short-term* or *long-term loans*, as appropriate, while an increase in *bonds and notes* is recorded.

Flow data

8.16 In the flow data in the balance of payments, both the extinguishment of the old debt liability and the creation of the new debt(s) are recorded. In the DAC system these flows are also recorded, except when the category of debt does not change, in which case only the capitalization of interest is recorded as a flow. The DRS does not record these transactions in flow data (but they are reflected in

[4] If external debt is lower or higher because at the time of rescheduling it was agreed between the debtor and creditor that the amount of late interest on arrears was to be more or less than that which accrued, back data of the gross external debt position should not be revised to reflect this agreement, provided that the accrual of interest costs on arrears in past periods was in line with the contract(s) that existed at that time.

Box 8.1. Sovereign Bond Restructuring

The restructuring of a country's sovereign bonded external debt (eurobonds and Brady bonds) began with Pakistan at the end of 1999, following the extension of the "comparability of treatment" principle to bondholders in Pakistan's agreement with the Paris Club in January 1999.

In terms of restructuring debt, bonds have a number of characteristics that distinguish them from other types of debt instruments.

- First, there is usually a wider range of investors than for nontraded external debt instruments, and hence various investor groups all with potentially different investment motivations. For instance, the investment motivations of retail—nonfinancial institution—investors may be different from those of financial institutions.
- Second, market prices are invariably quoted. Thus, those investors that mark-to-market frequently—having borne the market-value loss in the secondary market price of the to-be-exchanged bonds, or having purchased at a low market value—might well compare the present value of the exchange offered (discounting payments at a particular interest rate) with the current market price of the to-be-exchanged bonds. In the simplest case, if the present value of the exchange bond is higher than the market price of the original bond, the holder of the to-be-exchanged bond has an incentive to tender his bonds in the exchange.
- Finally, most eurobonds and Brady bonds have cross-default clauses or cross-acceleration clauses in their covenants, thus perhaps making it impossible for a sovereign debtor to pick and choose which bondholders are repaid and which are not. So, markets debate the issue of whether a restructuring of external bonded debt needs to be comprehensive across other foreign currency debt instruments as well.

The consequence of the above is that successful bond restructuring—mostly bond exchanges—has involved the debtors exchanging securities at a premium to the market price, although well below the face value, or providing other "sweeteners" to encourage bondholders to participate. Bonds with the larger percentage of retail investors have tended to pay a higher premium. But, as with creditors for other types of debt instruments, a key consideration of creditors in any restructuring is whether the sovereign borrower is facing a liquidity or solvency problem, or neither.

the position data). In the balance of payments, any difference between the value of the old and new debts is treated as a valuation change, such as in the case of exchanges of Brady bonds (see Box 8.1) for new global bonds, except when nonmarketable debt owed to official creditors is involved, in which instance any reduction in the nominal value of debt is recorded as debt forgiveness (see below).[5]

[5]See *BPM5*, paragraph 534.

Debt reduction

8.17 The *Guide* recommends that debt reduction arising from debt rescheduling and debt refinancing—that is, a reduction in the nominal amount outstanding, excluding any external debt-service payments made by the debtor as part of the arrangement—be measured and presented as in the debt-reduction table provided in this chapter. If the new external debt liability is denominated in a different currency from that of the external debt liability it is replacing, then any debt reduction should be determined using the market exchange rate between the two currencies prevailing on the transaction date (that is, the midpoint between the buying and selling spot rates).

8.18 In many instances of debt rescheduling, the method by which debt relief is provided is more complex than a simple reduction in nominal amount outstanding. For instance, a debt might be rescheduled with the same nominal value but with a lower interest rate or with extended maturities. By simply comparing the nominal amounts outstanding before and after the rescheduling, no debt reduction would be evident, but there may be debt reduction in present value terms, calculated by discounting future debt-service payments, both on the old and new debts, at a common rate. In such circumstances, a key issue is which rate to use: in debt-reorganization operations such as those under the HIPC Initiative and similar arrangements, debt reduction in present-value terms is calculated using an interest rate equal to a market-based so-called risk-neutral rate—such as the OECD's Commercial Interest Reference Rates (CIRRs).[6] In other cases, debt reduction in present value may be based on a rate that includes a risk premium, reflecting the creditor's assessment of the value of the claim (this is generally the case for the restructuring of claims held by private creditors).

8.19 Also, in some debt rescheduling, such as with concessional Paris Club agreements (Box 8.2), credi-

[6]These rates are determined monthly for 13 currencies on the basis of secondary market yields on government bonds with a residual maturity of five years, and additionally three and seven years for the Canadian dollar, the U.S. dollar, and the euro. These data are published monthly on the Internet at: *http://www.oecd.org/statistics/news-releases*. For the HIPC Initiative, debt denominated in currencies for which no CIRR is available, if the currency is pegged to another currency such as the U.S. dollar, the CIRR for the latter should be used; in the absence of an exchange rate arrangement, as well as for the units of account used by various multilateral institutions, the SDR CIRR should be applied.

Box 8.2. Paris Club and Commercial Bank Debt Relief

The Paris Club has developed procedures for the collective rescheduling of official bilateral debt since the 1950s, when Argentina approached bilateral creditors. The Club is an ad hoc organization of creditor countries (mainly OECD members) that responds to requests for debt relief with respect to guaranteed export credits and intergovernmental loans.

Debts to Paris Club official creditors are now restructured through the Paris Club, especially since Russia became a member of the Club in 1997. Debts to commercial banks are typically restructured through consortia of commercial banks. Noninsured supplier credits and debts to governments that do not participate in the Paris Club are normally restructured through bilateral negotiations.

Paris Club

The Paris Club is an informal group of creditor countries. The French Treasury maintains a permanent secretariat, and a senior official serves as Chairman, to administer the Paris Club on behalf of other creditor countries. There are 19 permanent members; nonmember creditor countries may be invited to take part in meetings for the treatment of the debt of a specific debtor country if they have significant claims on that country. The Club meets virtually every month in Paris, both for discussion of debt issues among the permanent members and for the rescheduling of the debt of a specific debtor country.

Countries facing difficulties in servicing of debt to official bilateral creditors will approach the Chairman of the Paris Club and ask to be considered for relief. The creditors at their monthly meeting will agree to hear that country's application, provided that an IMF-supported adjustment program is in place and that there is a financing need that requires rescheduling. Agreement is normally reached in face-to-face negotiations, or by mail if there are very few creditors. The Paris Club can "treat" debt owed (contracted or guaranteed) by the government and/or the public sector of the debtor country to creditor countries or their appropriate institutions: officially guaranteed export credits and bilateral loans. The representatives of the creditor countries at the Paris Club decide on the period over which debt relief will be given (known as the consolidation period), the debts that will be included (current maturities, possibly arrears, possibly previously rescheduled debt), and the repayment terms on consolidated debt (grace and repayment periods).

Two types of "treatment" may be implemented by the Paris Club:
- A flow treatment of usually both scheduled amortization and interest payments falling due in a given period; and
- A stock treatment of the entire outstanding principal at a given date, for countries with a good track record with the Paris Club if this would ensure an end to the rescheduling process.

Paris Club negotiations result in a multilateral framework agreement (Agreed Minute), which must be followed up with bilateral implementing agreements with each creditor agency. The interest rate on rescheduled debt (known as moratorium interest) is not arranged at the Paris Club but is negotiated bilaterally, reflecting market rates.

At the beginning of the debt-relief process, Paris Club creditor countries will establish a "cutoff date." This means that all loan contracts signed after that date will not be eligible for debt relief by the Paris Club. The aim is to help the debtor country reestablish its creditworthiness by paying new obligations on their original schedules. Even though debt relief may extend over many years through a succession of Paris Club agreements, the cutoff date will remain unchanged.

It was increasingly recognized in the 1980s that some low-income countries with high external debt were facing solvency as well as liquidity problems. Over the years, the Paris Club has provided increasingly concessional rescheduling terms to low-income countries. The level of debt reduction on commercial claims was gradually increased from Toronto terms (1988—33.33 percent debt reduction) to London terms (1991—50 percent debt reduction) to Naples terms (1995—50 percent to 67 percent debt reduction) to Lyon terms (1996—80 percent debt reduction) and to Cologne terms (1999—90 percent reduction or more if needed under the HIPC Initiative). The evolution of Paris Club terms up to Lyon terms is presented in Table 8.2.

In 1996, the debt initiative for heavily indebted poor countries (HIPCs) was established, leading for the first time to multilateral creditors providing debt relief to a country. The Paris Club provides its debt-relief effort in the context of the HIPC Initiative through the use initially of Lyon terms, and now of Cologne terms.

A country benefiting from Paris Club debt relief commits to seek at least similar restructuring terms from its other external creditors (other than multilateral creditors, which only provide debt relief to countries eligible for assistance under the HIPC Initiative). This applies to non–Paris Club bilateral creditors, who generally negotiate with the debtor country on a bilateral basis, as well as private creditors (suppliers, banks, bondholders, etc.).

Paris Club agreements may include a debt-swap provision, within a limit usually set at 20 percent of commercial claims. Paris Club creditors on a bilateral basis conduct debt-swap operations.

Commercial Bank Debt Relief

Multilateral debt relief is much more difficult to organize for commercial banks than for official creditors. While a national export credit insurer can negotiate on behalf of any individual creditor, there is no way to consolidate national commercial bank claims. Rather, each creditor bank must approve the resulting agreement and, for loan syndication, the number is often in the hundreds.

The pattern of negotiations was established in a 1970 agreement between the Philippines and its commercial bank creditors. Creditor banks form a committee (sometimes known as the London Club) of about a dozen people who represent the major creditor banks. The composition of the committee—which can be completely different from case to case—takes into account the nationality of the banks in the consortium so that the negotiations can make provision for the different tax and regulatory systems that affect banks of different countries. The committee negotiates an "agreement in principle" with debtor country representatives. After all creditor banks approve this agreement, it is signed. It takes effect when certain requirements are met, such as payment of fees and of arrears. As with the rescheduling of debts to official creditors, banks provide debt relief normally in the context of a debtor country's adjustment program supported by an IMF arrangement. Unlike with Paris Club creditors, there is no "cutoff" date.

Commercial bank agreements restructure principal; consolidation of original interest costs is rare. Like Paris Club agreements, consolidation of short-term debt is also unusual (but when a major portion of arrears has arisen from short-term debt, there is often no option but to restructure). Among the initiatives for reducing the commercial debt burden was the Brady Plan (1989). This market-based debt-restructuring initiative provided a menu of options to the creditor banks. These included buybacks—the debtor government repurchases debt at a discount that is agreed upon with the creditor banks; an exchange of debt into bonds at a discount but offering a market rate of interest (discount bonds); and an exchange at par into bonds that yielded a below-market interest rate (interest-reduction bonds). The discount bonds and the interest-reduction bonds were fully collateralized by zero-coupon U.S. government securities for principal and partially collateralized for interest payments.

tors are offered a choice between different options, one of them being a partial debt reduction, the other one being a rescheduling at a reduced interest rate (debt reduction in present value terms). Some creditors may forgive part of the claims and reschedule the outstanding part at the appropriate market rate ("debt-reduction" option), whereas other creditors reschedule the whole claim at a lower interest rate ("debt-service-reduction" option), resulting in a debt reduction in present value equivalent to the one granted by creditors that chose the "debt-reduction" option. Table 8.2 shows the variety and evolution of Paris Club debt-rescheduling terms.

8.20 Because of the complexities involved, and the different interest rates that may be employed, international statistical standards have not developed to the point where there is general agreement on how to measure and make comparable the different methods of providing debt reduction in present-value terms.

8.21 Given the above, the *Guide* provides no recommended guidance on measuring and presenting debt reduction in present-value terms. Nonetheless, economies that undergo debt rescheduling and refinancing are encouraged to disseminate (1) the total nominal amounts involved; (2) the amount of debt reduction in present-value terms they have achieved—the difference between the present values (using a common interest rate) of the rescheduled/refinanced debt-service payments before and after rescheduling/refinancing (present-value method);[7] and (3) provide detailed information on how the amount of the present-value reduction was calculated, including the interest rate(s) used.

8.22 Similarly, no guidance is provided for measuring debt relief in terms of an increase in duration because of the difficulty in measuring such relief and presenting it in a manner that is comparable with other forms of debt reorganization.

Debt Forgiveness

8.23 Debt forgiveness is defined as the voluntary cancellation of all or part of a debt obligation within a contractual arrangement between a creditor in one economy and a debtor in another economy.[8] More specifically, the contractual arrangement cancels or forgives all or part of the principal amount outstanding, including interest arrears (interest that fell due in the past) and any other interest costs that have accrued. Debt forgiveness does not arise from the cancellation of future interest payments that have not yet fallen due and have not yet accrued.

8.24 If the debt reorganization effectively changes the contractual rate of interest—such as by reducing future interest payments but maintaining future principal payments, or vice versa—it is classified as debt rescheduling. However, in the specific instance of zero-coupon securities, a reduction in the principal amount to be paid at redemption to an amount that still exceeds the principal amount outstanding at the time the arrangement becomes effective could be classified as either an effective change in the contractual rate of interest, or as a reduction in principal with the contractual rate unchanged. Unless the bilateral agreement explicitly acknowledges a change in the contractual rate of interest, such a reduction in the principal payment to be made at maturity should be recorded as debt forgiveness.

Recommended treatment

External debt position and debt reduction

8.25 Debt forgiveness reduces the gross external debt position by the value of the outstanding principal that has been forgiven. Any reduction in principal is recorded under the appropriate debt instrument when it is received—that is, when both the debtor and creditor record the forgiveness in their books. Where possible, debt forgiveness in nominal terms should be separately identified and recorded under *debt reduction* in Table 8.1.

8.26 If forgiveness relates to payments on debt obligations that are past due and are yet to be paid—that is, arrears of interest and principal—a reduction in the gross external debt position under *arrears* is recorded. Forgiveness of interest costs that have

[7]The payment schedule for both the original and rescheduled debt could also be provided as memorandum information.

[8]This includes forgiveness of some or all of the principal amount of a credit-linked note due to an event affecting the entity on which the embedded credit derivative was written, and forgiveness of principal that arises when a type of event contractually specified in the debt contract occurs—for example, forgiveness in the event of a type of catastrophe.

Table 8.2. Evolution of Paris Club Rescheduling Terms

			Low-Income Countries[2]															
			Toronto Terms Options			London Terms[3] Options				Naples Terms[4] Options					Lyon Terms[5] Options			
											DSR							
	Middle-Income Countries	Lower-Middle-Income Countries (Houston terms)[1]	DR	DSR	LM	DR	DSR	CMI	LM	DR	Maturing flows	Stocks	CMI	LM	DR	DSR	CMI	LM
Implemented	Since September 1990		Oct. 1988–Jun. 1991			Dec. 1991–Dec. 1994				Since January 1995					Since December 1996			
Grace (in years)	5–6[1]	Up to 8[1]	8	8	14	6	—	5	16[6]	6	—	3	8	20	6	8	8	20
Maturity (in years)	9[1]	15[1]	14	14	25	23	23	23	25	23	33	33	33	40	23	40	40	40
Repayment schedule	Flat/ Graduated	Flat/ Graduated	Flat			Graduated				Graduated					Graduated			
Interest rate[7]	M	M	M	R[8]	M	M	R[9]	R[9]	M	M	R[10]	R[10]	R[10]	M	M	R[11]	R[11]	M
Reduction in present value (in percent)	—	—	33	20–30[12]	—	50	50	50	—	67	67	67	67	—	80	80	80	—
Memorandum items																		
ODA credits																		
Grace (in years)	5–6	Up to 10	14	14	14	12	12	12	16	16	16	16	16	20	16	16	16	20
Maturity (in years)	10	20	25	25	25	30	30	30	25	40	40	40	40	40	40	40	40	40

Source: Paris Club.

[1]Since the 1992 agreements with Argentina and Brazil, creditors have made increasing use of graduated payments schedules (up to 15 years' maturity and 2–3 years' grace for middle-income countries; up to 18 years' maturity for lower-middle-income countries).

[2]DR refers to the debt-reduction option; DSR to the debt-service-reduction option; CMI denotes the capitalization of moratorium interest; LM denotes the nonconcessional option providing longer maturities. Under London, Naples, and Lyon terms, there is a provision for a stock-of-debt operation, but no such operation took place under London terms.

[3]These have also been called "Enhanced Toronto" and "Enhanced Concessions" terms.

[4]Most countries are expected to secure a 67 percent level of concessionality; countries with a per capita income of more than $500, and an overall indebtedness ratio on present-value loans of less than 350 percent of exports may receive a 50 percent level of concessionality decided on a case-by-case basis. For a 50 percent level of concessionality, terms are equal to London terms, except for the DSR option under a stock-of-debt operation that includes a three-year grace period.

[5]These terms are to be granted in the context of concerted action by all creditors under the HIPC Initiative. They also include, on a voluntary basis, an official development assistance (ODA) debt-reduction option.

[6]Fourteen years before June 1992.

[7]Interest rates are based on market rates (M) and are determined in the bilateral agreements implementing the Paris Club Agreed Minute. R = reduced rates.

[8]The interest rate was 3.5 percentage points below the market rate or half of the market rate if the market rate was below 7 percent.

[9]Reduced to achieve a 50 percent present-value reduction.

[10]Reduced to achieve a 67 percent present-value reduction; under the DSR option for the stock operation, the interest rate is slightly higher, reflecting the three-year grace period.

[11]Reduced to achieve an 80 percent present-value reduction.

[12]The reduction of present value depends on the reduction in interest rates and therefore varies. See footnote 8.

accrued during the period or amounts disbursed in the current recording period has no impact on the gross external debt position at the end of the period because any increase in the outstanding value of the debt instrument is matched by the debt forgiveness. However, any such forgiveness should be reported under *debt reduction* in Table 8.1.

8.27 A special case of debt forgiveness is where the creditor provides a grant to the debtor that is used to pay the debt-service payments as they fall due. In such instances, the gross external debt position is only affected when debt-service payments are made—that is, the same as for all debt instruments being serviced. Nonetheless, such assistance is recorded in the table as *debt reduction* when the debt-service payments are made.

Flow data

8.28 In flow terms, debt forgiveness is recorded in the balance of payments as a capital transfer, and in the DAC and DRS systems as a debt-forgiveness grant. The counterpart transaction in the balance of payments and DAC is a repayment of the principal owed. When debt forgiveness is in the form of a grant by the creditor to the debtor (as in the previous paragraph), repayment of the principal owed is generally similarly recorded in the DRS.

Debt Conversion and Debt Prepayments

8.29 External debt conversion is an exchange of debt—typically at a discount—for a non-external debt claim, such as equity, or for counterpart funds, such as can be used to finance a particular project or policy. Debt-for-equity, debt-for-nature, and debt-for-development swaps are all examples of debt conversion. A debt buyback is the repurchase, usually at a discount, by a debtor economy (or on its behalf) of all or part of its external debt. It may be undertaken on the secondary market or through negotiations with creditors.

Debt conversion

8.30 Rather than exchanging debt for debt, countries might enter into a debt conversion process—the legal and financial transformation of an economy's liability. Typically, debt conversions involve an exchange of external debt in foreign currency for a nondebt obligation in domestic currency, at a discount. In essence, external debt is prepaid, and the nature of the claim on the economy is changed. An example is a foreign currency debt-for-equity swap, which results in debt claims on the debtor economy being reduced, and nonresident investments in equity investments increased. Debt-for-equity swaps often involve a third party, usually a nongovernmental organization or a corporation, which buys the claims from the creditor and receives shares in a corporation or local currency (to be used for equity investment) from the debtor. Other types of debt swaps such as external debt obligations for exports (debt for exports), or external debt obligations for counterpart assets that are provided by the debtor to the creditor for a specified purpose such as wildlife protection, health, education, and environmental conservation (debt for sustainable development), are also debt conversions.

Prepayments and buybacks

8.31 Prepayments consist of a repurchase, or early payment, of debt at conditions that are agreed between the debtor and the creditor; that is, debt is extinguished in return for a cash payment agreed between the debtor and the creditor. When a discount is involved relative to the nominal value of the debt, prepayments are referred to as buybacks. Also, debtors may enter the secondary market and repurchase their own debt because market conditions are such that it is advantageous financially to do so.

Recommended treatment

External debt position

8.32 For both debt conversions and debt prepayments, a reduction in the gross external debt position is recorded to the value of the debt instruments that are extinguished, irrespective of the value of the counterpart claim (or assets) being provided. This reduction in gross external debt position should be recorded at the time when the debt instrument is extinguished; more accurately, the gross external debt position no longer includes debt that has ceased to exist.

Flow data

8.33 In the transaction data in the balance of payments, the reduction in the outstanding debt instrument is recorded at the value of the counterpart claim (or assets). Any difference in value is recorded as a valuation change in position data. An exception

arises when nonmarketable debt owed to official creditors is involved, and the counterpart claim (assets) has a lower value than the debt, in which instance both the debt instrument and the counterpart claim (or assets) are separately valued, and any difference in value is recorded as debt forgiveness in the balance of payments. The DAC system employs a similar approach, except that all differences in value are classified as transactions and not as valuation changes provided that they are the result of bilateral negotiation and there is a development motive for the operation. The DRS records both the reduction in the nominal value of the debt instrument and the value at which the debt was repurchased, allowing the discount to be measured.

Debt reduction

8.34 Where official debt is exchanged for equity or counterpart funds to be used for development purposes, the difference between the value of the debt being extinguished and the counterpart claim or funds provided is classified as *debt reduction*.[9] This includes cases where the buyback of debt is by a third party, such as a nongovernmental organization or a corporation, which then sells the debt back to the debtor at a discount, under a deal that is arranged under a bilateral arrangement between debtor and government creditor.

8.35 In other cases, replacing a debt instrument with another type of claim may only be the recognition of reality. In other words, and particularly for marketable instruments, the price at which the debtor is willing to repurchase the debt may be greater than the price at which the debt previously traded. So, if the creditor purchased the security at the lower market price, the creditor might be making a holding gain.

8.36 The *Guide* recommends that in measuring and presenting data on debt reduction from such transactions, a distinction is made between (1) collaborative arrangements arising from discussions between the creditor(s) and debtor; and (2) buybacks that are initiated by the debtor through purchases in the secondary market. When buybacks arise from collaborative arrangements, any difference between the value of the counterpart claims (or assets) provided by the debtor and the nominal amount bought back should be recorded as *debt reduction* in Table 8.1. Debt reduction arising from buybacks in the secondary market initiated by the debtor should not be recorded as *debt reduction* in the table.

8.37 For both public and private sector transactions, if external debt and the counterpart claims (or assets) are denominated in different currencies, any debt reduction should be determined using the market exchange rate between the two currencies prevailing on the transaction date (the midpoint between the buying and selling spot rates).

Presentation of Data on Debt Reduction

8.38 In Table 8.1, as far as possible, economies should present information on *debt reduction* according to the sector of the debtor (public-sector-based approach), and by type of creditor. Additionally, the table captures information on debt reduction arising from debt reorganization of bonds and notes.

8.39 Also, data could be presented by type of debt reorganization under which the debt reduction was given: (1) debt rescheduling; (2) debt forgiveness; and (3) debt conversion and debt prepayments. Where a debt-relief package includes elements of more than one type, separately identifying each type is encouraged. For example, if a part of the debt is to be repaid for cash, a prepayment should be recorded; if part of the debt is cancelled, debt forgiveness should be recorded; if the repayment terms of part of the debt are changed, a debt rescheduling should be recorded. But if it is not possible to provide separate identification, all debt reduction should be included along with the dominant type of reorganization in the package.

8.40 In Table 8.1, debt reduction should be recorded at the time when the external debt is reduced. If all debt reduction occurs at one time, debt reduction should be recorded at that time rather than when the debt-service payments would have fallen due. However, it is recognized that national practices may differ in this regard, and if the latter approach is followed, it should be recorded in a note to the presentation of the debt-reduction data.

8.41 Debt reorganization might also be phased over a period of time, such as under multiphase contracts,

[9] In the DAC system it is classified as debt forgiveness, and in the DRS it is classified as debt reduction.

performance-related contracts, and when debt reduction is dependent on contingent events. In such circumstances, debt reduction is recorded when the change in debt-service payment schedule of the debtor takes effect—for instance, if debt reduction occurs when the debt-service payments fall due, then this is the time when the debt reduction is recorded.

8.42 As noted above, the exchange rate used to calculate debt reduction should be the market rate on the transaction date (the midpoint between the buying and selling spot rates).

8.43 It is recommended that methodological notes accompany the presentation of debt-reduction statistics. Inter alia, these notes should cover each type of debt reorganization.

8.44 In Table 8.1, debt reduction is measured only in nominal value terms. This is because the analytical usefulness of presenting debt-reduction data in market-value terms is uncertain. For instance, when an economy faces payment difficulties (which is systematically the case when the country receives debt reduction), its debt is generally valued at a deep discount, since the market is still uncertain about the prospects of payment. In such circumstances, debt reorganization can result in the new debt having a higher value than the old debt. Similarly, in most cases (and in all multilateral agreements, such as those of the Paris Club or the London Club—see Box 8.1—or the HIPC Initiative), debt relief aims to restore the creditworthiness of the debtor country, thus increasing the possibility of repayment of existing debts and hence raising their market value. While there may be analytical interest in measuring the effect of debt reorganization on the value of outstanding debt—that is, the amount by which the market value rises—changes in the nominal amount outstanding rather than the market value is the preferred approach to measuring debt reduction arising from debt reorganization.

Other Transactions Relating to Debt Reorganization

Debt Assumption

8.45 Debt assumption is a trilateral agreement between a creditor, a former debtor, and a new debtor under which the new debtor assumes the former debtor's outstanding liability to the creditor and is liable for repayment of the debt.

8.46 Debt assumption is recorded—in the transaction and position data—when the creditor invokes the contract conditions permitting a guarantee to be called. If debt assumption arises under other circumstances, it is recorded when the liability is actually removed from the debtor's balance sheet, and the corresponding entries made in the new debtor's balance sheet, and not necessarily the time when agreement was reached to make the debt assumption. The recording by the entity assuming the debt has to be made in one time period: the successive dates of repayment previously foreseen in the context of the former debt are not relevant.

8.47 After it has been assumed, the debt, which was originally a liability of the former debtor, becomes a liability of the new debtor. The debt may carry the same terms as the original debt, or new terms may come into force because the guarantee was invoked. If the original and new debtors are from different institutional sectors, the external debt of the institutional sector of the original debtor is reduced, and the external debt of the institutional sector of the new debtor increased. The amount to be recorded by the new debtor is the full amount of the outstanding debt that is assumed. No debt reduction is recorded, unless there is an agreement with the creditor to reduce the external debt.

8.48 An example of debt assumption could be a government taking over the debts of a corporation. If, in such an example, the government acquires a financial claim on the corporation as a consequence of the debt assumption, the corporation will need to record a new debt liability, which is classified as external debt only if the government and corporation are residents of different economies. Every transfer of liabilities between a quasi-corporation and its owner is reflected in the value of its equity stake.

8.49 Rather than assume the debt, a government may decide to repay a specific borrowing or make a specific payment on behalf of another institutional unit, without the guarantee being called or the debt being taken over. In this case, the debt stays recorded solely in the balance sheet of the other institutional unit, the only legal debtor. If a new liability is created in the form of a government claim on the debtor, this is classified as external debt only if the

government and other institutional unit are residents of different economies (and the debtor is not a quasi-corporation of the government).

Borrowing for Balance of Payments Support

8.50 Borrowing for balance of payments support refers to borrowing (including bond issues) by the government or central bank (or by other sectors on behalf of the authorities) to meet balance of payments needs.[10] In the external debt statement, unlike the analytical presentation of the balance of payments, no special "below-the-line" recording of these borrowings or their advance repayment is required.

[10]A balance of payments need is defined more fully in paragraphs 451 through 453 of *BPM5*.

New Money Facilities

8.51 Some debt-reorganization packages feature new money facilities (new loan facilities that may be used for the payment of existing debt-service obligations). In the gross external debt position, outstanding drawings by the debtor on new money facilities are usually recorded under *long-term loans*. If the existing debt liabilities remain outstanding, they should continue to be reported in the gross external debt position, until they are repaid. New money facilities are not to be recorded as debt reduction.