Debt Reorganization

Introduction

8.1 Debt-reorganization transactions are a feature of external debt activity (see Box 8.1). 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 DAC system, and the World Bank's Debtor Reporting System (DRS). Full details of such recording approaches are set out in BPM6 (IMF, 2009), the OECD's Handbook for Reporting Debt Reorganization on the DAC Questionnaire (OECD, 2000), and the Debtor Reporting System Manual (World Bank, 2000).

Definitions

8.3 Debt reorganization (also referred to as debt restructuring) is defined as arrangements involving both the creditor and the debtor (and sometimes third parties) that alter the terms established for servicing an existing debt. Types of debt reorganization include debt forgiveness, rescheduling, refinancing, conversion, prepayments, and assumption. Governments are often involved in debt reorganization, as a debtor, creditor, or guarantor, but debt reorganization can also involve the private sector, such as through debt exchanges.

8.4 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.

8.5 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, i.e., 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 a small decrease in duration) or a sharp increase in duration (together with a small increase in present value).
8.6 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 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.

8.7 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). 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.

Types of Debt Reorganization

8.8 The four main types of debt reorganization are:

- 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 BPM6 and the DRS, and is also classified as debt forgiveness in the DAC system if it is in the framework of a bilateral agreement and there is a development/welfare motive.

- 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. Depending on the nature of the transaction undertaken, the reorganization is described as debt rescheduling or refinancing (or debt exchanges). Included

| Table 8.1 Nominal Value Debt Reduction Arising from Debt Reorganizations: by Debtor and Creditor Sectors |
|---------------------------------------------------|---------------------------------------------------|---------------------------------------------------|---------------------------------------------------|---------------------------------------------------|---------------------------------------------------|---------------------------------------------------|
| Debt position before debt reorganization (1) | Debt reduction due to: | Debt position after debt reorganization (7) = (1) − (2) |
| Total (2) = (3) + (4) + (5) + (6) | Debt forgiveness (3) | Debt rescheduling and refinancing (4) | Debt conversion and pre-payment (5) | Debt assumption (6) |
| Public sector external debt | | | | | |
| Of which: | | | | | |
| Multilateral | | | | | |
| Official bilateral | | | | | |
| Commercial bank¹ | | | | | |
| Debt securities | | | | | |
| Publicly guaranteed private sector external debt | | | | | |
| Of which: | | | | | |
| Multilateral | | | | | |
| Official bilateral | | | | | |
| Commercial bank¹ | | | | | |
| Debt securities | | | | | |
| Private sector external debt not publicly guaranteed | | | | | |
| Of which: | | | | | |
| Multilateral | | | | | |
| Official bilateral | | | | | |
| Commercial bank¹ | | | | | |
| Debt securities | | | | | |

¹Excluding debt securities.

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.
are transactions that change the type of debt instrument owed—e.g., loan for bond swaps—but are not debt-forgiveness transactions. 

- 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, and debt prepayment or debt buybacks for cash.

- A new debtor assumes the former debtor’s outstanding liability to the creditor and is liable for repayment of the debt. This is *debt assumption* where a third party is also involved.

**8.9** Debt-reorganization packages may involve more than one type, e.g., most debt-reorganization packages involving debt forgiveness also result in a rescheduling of the part of the debt that is not forgiven or canceled.

**8.10** For clarification purposes, in discussing the statistical treatment of debt reorganization, each of the four 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, so there is an analytical benefit, where possible, in separately measuring and reporting any debt reduction resulting from their application.

**Debt Forgiveness**

**8.11** 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. 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.

**8.12** 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 (in which case the change should be recorded as debt rescheduling), 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**

**8.13** 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, i.e., 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.

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

---

5 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 debt forgiveness, as counterpart funds are not provided to the creditor.

6 This includes forgiveness of some or the entire 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, e.g., forgiveness in the event of a type of catastrophe.
8.15 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, i.e., 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**

8.16 In flow terms, debt forgiveness is recorded in the balance of payments as a capital transfer receipt of the debtor economy (capital transfer payment of the creditor economy), and in the DAC system and the DRS as a debt-forgiveness grant. The counterpart transaction in the balance of payments and DAC is an offsetting entry for the amount of principal owed. When debt forgiveness is in the form of a grant by the creditor to the debtor (as in the previous paragraph), no transaction is recorded in the DRS; the amount forgiven is reflected as a reduction in the position data.

**Debt Rescheduling and Refinancing**

8.17 Debt rescheduling and refinancing involve a change in an existing debt contract and/or replacement by a new debt contract, generally with extended debt service payments. Debt rescheduling is a bilateral arrangement between the debtor and the creditor that constitutes a formal deferment of debt-service payments and the application of new and extended maturities to the deferred amount. This is achieved through a change of the terms and conditions of the existing contracts. The new terms of rescheduling normally include one or more of the following elements: extending repayment periods, reductions in the contracted interest rate, adding or extending grace periods for the repayment of principal, fixing the exchange rate at favorable levels for foreign currency debt, and rescheduling the payment of arrears, if any. 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.

8.18 Refinancing of a debt liability involves the replacement (in full or partial) 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 paragraph 8.54). 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).

8.19 Rescheduling (for instance, under a Paris Club agreement) 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.8

8.20 **Debt service moratorium extended by creditors** is a special case of debt rescheduling that involves an individual creditor permitting the debtor a formal suspension of debt service payments falling due within a given period. Debt service moratorium may be granted in the event of natural disasters, such as the moratorium granted to tsunami-affected countries in 2005, and usually involves formal exchange of letters but not necessarily a formal bilateral agreement. As the intention of the action is to provide the debtor with short-term debt relief, debt service moratorium extended by creditors should be classified as debt rescheduling, provided there is some formal process that demonstrates agreement on behalf of both the debtor and creditor, such as the exchange of letters, to delay payment. In such instances, arrears are not created.

8.21 **Debt service falling due between Paris Club agreed minute date and specified implementation date** is another special case of debt rescheduling.

---

8 Flow treatments aim at closing the debtor country’s financing gap. Stock treatments apply not only to the payments due over a given period of time, but to the entire position of certain debts. The aim of agreements covering debt positions is to provide a country with a final Paris Club treatment (called an “exit treatment”).
Under Paris Club debt rescheduling arrangements, creditor countries as a group usually agree in the non-binding “Agreed Minute” that they sign, that payment terms and conditions of applicable debt falling due before the specified effective (implementation) date of the Paris Club bilateral agreement might not be paid on schedule. However, interest continues to accrue based on the existing loan terms, but payments are not made, up until the point when there is a formal bilateral agreement. When such payments fall due, they are considered technical arrears (see paragraph 3.44) and are treated in the debtor economy as rescheduled short-term debt.

**Recommended treatment**

**External debt position**

8.22 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. If no precise time is determined, the time at which the creditor records the changes in its books is decisive. If the rescheduling of obligations due beyond the current period is linked to the fulfillment of certain conditions by the time the obligations fall due (such as multiyear Paris Club rescheduling), entries are recorded only in the period when the specified conditions are met. Whether the gross external debt position—both under debt rescheduling and debt refinancing—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. 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.

8.23 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, e.g., in the HIPC Initiative, a market-based rate is used.

8.24 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 debt securities is recorded.

**Flow data**

8.25 In the transaction 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 gives rise to a new flow. The DRS does not record these transactions in flow data (but they are reflected in the position data). In the balance of payments, the transaction is recorded at the value of the new debt instrument and 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. However, when nonmarketable debt owed to official creditors is involved, any reduction in the nominal value of debt is recorded as debt forgiveness.

---

9 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.

10 Both the integrated IIP statement and the integrated external debt position statement (i.e., the statement that emphasizes how changes in the position result from valuation changes, and other changes in volume during the reference period—see Table 7.16), reflect the transactions extinguishing the old debt instrument and creating the new debt instrument along with any valuation change recorded as revaluations.

11 See BPM6, paragraphs A2.12–A2.13 and A2.16–A2.19.
Sovereign debt restructurings have been a pervasive phenomenon, amounting to more than 600 cases in 95 countries between 1950 and 2010. One-third of these external debt restructurings were debt exchanges with private creditors (commercial banks and bondholders) and about two-thirds have been Paris Club agreements for official bilateral debt (see Box 8.2). There have also been debt restructuring operations under the Heavily Indebted Poor Countries (HIPC) and MDRI initiatives, which provided extensive relief and debt forgiveness (see Appendix 5).

The process of debt renegotiations between governments and commercial banks is typically labeled as “London Club” restructurings (see Box 8.2). Despite its name, the London Club is neither a statutory institution based in London nor a well-organized club. Instead, the term loosely describes the case-by-case restructuring routine developed between major Western banks and developing country governments in the late 1970s and early 1980s. Notwithstanding legal, coordination, and logistical issues, holdouts, and intercreditor disputes, there have been more than 100 restructurings between 1980 and 1990 under the umbrella of the London Club.

The Brady Plan was launched in March 1989 to address debtor insolvency and commercial bank exposure. The plan signaled a shift in the official policy stance on debt restructuring from short-term relief to face value reductions in debt to restore debtor solvency. It had three key elements: first, banks exchanged their loans for sovereign bonds; second, creditors were offered a menu of options in respect of instruments with different terms and implications for present value and face value reductions; and third, it provided for the capitalization of the interest arrears that were not written off by commercial banks. There were 17 deals (mostly in Latin America) between 1989 and 1997 under this plan; debtor countries normalized their relations with creditors, and the agreements also allowed them to regain access to capital markets.

**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. A new generation of sovereign bond debt restructurings has since extended to a number of emerging market countries such as the Ukraine (2000), Russia (2000), Ecuador (2000 and 2009), Moldova (2002), Uruguay (2003), Dominica (2004), Argentina (2005), Dominican Republic (2005), Grenada (2005), Belize (2007), Seychelles (2010), and Cote D’Ivoire (2010). Sovereign bonds are typically restructured through an exchange offer. This involves identifying bondholders, verifying their claims, preparing an exchange offer (most likely after consultation with the bondholders), launching the exchange offer, waiting for bondholder participation, and exchanging the debt.

In terms of restructuring debt, sovereign 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 nonnegotiable external debt instruments, and hence, various investor groups all with potentially different investment motivations, e.g., 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 offer (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 bonds in the exchange.
- Finally, most Eurobonds 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.

Sovereign bond restructurings have not always been smooth, and in some cases negotiations have been protracted. It is often argued that the presence of Collective Action Clauses (CACs) can facilitate creditor-debtor negotiations in a restructuring situation, since they reduce the hurdle of having to achieve unanimity on a restructuring agreement (via the majority restructuring clause) and can limit the potential threat of litigation from “holdout” creditors. However, the actual use of CACs in past debt restructurings shows mixed results (see Das, Papaioannou, and Trebesch, 2012). CACs specify how creditors are represented in negotiations, define majority voting procedures to alter the financial terms of the outstanding instruments, and can limit the incentive or ability of individual creditors to initiate litigation against the debtor. The use of CACs is now a well-established market practice for international bond issues.

---

Debt reduction

8.26 The Guide recommends that debt reduction arising from debt rescheduling and debt refinancing—i.e., 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 (i.e., the midpoint between the buying and selling spot rates).

8.27 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 CIRRs.\(^{12}\) 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).

8.28 Also, in some debt rescheduling, such as with concessional Paris Club agreements (Box 8.2), creditors are offered a choice between different options, one of them being a partial debt reduction, the other 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.

8.29 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.

8.30 Given the above, the Guide provides no recommended guidance on measuring and presenting debt reduction arising from debt rescheduling and refinancing 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);\(^{13}\) and (3) detailed information on how the amount of the present-value reduction was calculated, including the interest rate(s) used.

8.31 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 Conversion and Debt Prepayments

8.32 External debt conversion is an exchange of debt—typically at a discount—for a nonexternal debt claim, such as equity, or for counterpart funds that 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 prepayment is the repurchase, usually at a discount (in which case prepayments are referred to as buybacks), by a debtor economy (or on its behalf) of

\(^{12}\) These rates are determined monthly for 15 currencies on the basis of secondary market yields on government bonds. These data are published monthly on the Internet at www.oecd.org/. 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.

\(^{13}\) The payment schedule for both the original and rescheduled debt could also be provided as memorandum information.
Two types of “treatment” may be implemented by the Paris Club: restructured through bilateral negotiations. Debts to Paris Club official creditors are generally restructured through the Paris Club. Debts to commercial banks are typically restructured through consortia of commercial banks (often called London Club). Noninsured supplier credits and debts to governments that do not participate in the Paris Club are normally restructured through bilateral negotiations.

Paris Club

The French Treasury maintains a permanent secretariat, and a senior official serves as chairman. 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 every month in Paris, both for discussion of debt issues among the permanent members and for the restructuring of the debt of a specific debtor country.

Two types of “treatment” may be implemented by the Paris Club:

- A flow treatment of usually both scheduled amortization and interest payments falling due during the consolidation period—the period over which debt relief will be given
- A stock treatment of the outstanding principal at a given date

Paris Club negotiations result in a multilateral framework agreement (Agreed Minute), which must be followed up with bilateral implementing agreements with each creditor.

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 normally 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 usually remain unchanged, although under the Evian approach (see later in this box) this policy is evolving.

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 is presented in Table 8.2.

In 1996, the debt initiative for 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. The HIPC initiative demonstrated the need for creditors to take a more tailored approach when deciding on debt treatment for debtor countries.

In October 2003, Paris Club creditors adopted the “Evian Approach” with the aim of tailoring treatments to the need of non-HIPC debtors. Debt sustainability considerations are taken into account in accordance with the IMF’s standard debt sustainability framework, and the Paris Club’s response is adapted to the financial situation of debtor countries. The Evian approach aims to contribute to global efforts to make the resolution of financial crises more orderly, timely, and predictable.

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).

Note: HIPC = Heavily Indebted Poor Country
## Table 8.2 Evolution of Paris Club Rescheduling Terms

<table>
<thead>
<tr>
<th>Implemented</th>
<th>Middle Income Countries</th>
<th>Lower-Middle-income Countries (Houston Terms)</th>
<th>Low-Income Countries&lt;sup&gt;2&lt;/sup&gt;</th>
<th>Toronto terms options</th>
<th>London terms options&lt;sup&gt;3&lt;/sup&gt;</th>
<th>Naples terms options&lt;sup&gt;4&lt;/sup&gt;</th>
<th>Lyon terms options&lt;sup&gt;5&lt;/sup&gt;</th>
<th>Cologne terms options&lt;sup&gt;6&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>DR  DSR  LM</td>
<td>DR  DSR  CMI  LM</td>
<td>DR  DSR (matur- ing flows) DSR (stocks) CMI  LM</td>
<td>DR  DSR  CMI  LM</td>
<td>DR  DSR  CMI  LM</td>
<td>DR  DSR  CMI  LM</td>
<td>DR  DSR  CMI  LM</td>
<td>DR  DSR  CMI  LM</td>
</tr>
<tr>
<td>Non-ODA credits</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grace (in years)</td>
<td>5-6&lt;sup&gt;1&lt;/sup&gt;</td>
<td>8</td>
<td>6  5  16&lt;sup&gt;6&lt;/sup&gt;</td>
<td>6  8  20</td>
<td>6  8  20</td>
<td>6  8  20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maturity (in years)</td>
<td>9&lt;sup&gt;1&lt;/sup&gt;</td>
<td>14</td>
<td>23  23  25</td>
<td>23  33  33  33  40</td>
<td>23  40  40  40  40</td>
<td>23  40  40  40  40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Repayment schedule</td>
<td>Flat/Graduated</td>
<td>Flat/Graduated</td>
<td>Flat/Graduated</td>
<td>Graduated</td>
<td>Graduated</td>
<td>Graduated</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rate&lt;sup&gt;7&lt;/sup&gt;</td>
<td>M</td>
<td>M</td>
<td>M  R&lt;sup&gt;7&lt;/sup&gt; M  R&lt;sup&gt;7&lt;/sup&gt; M</td>
<td>M  R&lt;sup&gt;7&lt;/sup&gt; R&lt;sup&gt;7&lt;/sup&gt; R&lt;sup&gt;7&lt;/sup&gt; M</td>
<td>M  R&lt;sup&gt;7&lt;/sup&gt; R&lt;sup&gt;7&lt;/sup&gt; R&lt;sup&gt;7&lt;/sup&gt; M</td>
<td>M  R&lt;sup&gt;7&lt;/sup&gt; R&lt;sup&gt;7&lt;/sup&gt; R&lt;sup&gt;7&lt;/sup&gt; M</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Present value effort</td>
<td>(in percent)</td>
<td>33</td>
<td>50  50  50  --</td>
<td>67  67  67  67  --</td>
<td>80  80  80  --</td>
<td>90</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Memorandum items | ODA credits |                        |                             |                        |                        |                        |                        |                        |
| Grace (in years) | 5-6<sup>1</sup>       | 14                                          | 12  12  12  16            | 16  16  16  16  20  | 16  16  16  16  40  | 16  16  16  16  40  |                        |                        |
| Maturity (in years) | 10                  | 25                                          | 30  30  30  25            | 40  40  40  40  40  | 40  40  40  40  40  | 40  40  40  40  40  |                        |                        |

Source: Paris Club Secretariat.

1. Since the 1992 agreements with Argentina and Brazil, creditors have made increasing use of graduated payments schedules (up to 15 years’ maturity).
2. DR refers to the debt-reduction option; DSR to the debt-service-reduction option; CMI denotes the capitalization of moratorium interests; LM denotes the non-concessional option providing longer maturi-
3. ty. 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.
4. These have been called “Enhanced Toronto” and “Enhanced Concessions” Terms.
5. 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
6. 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
7. under a stock-of-debt operation that includes a three year grace period.
8. 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
9. option.
10. 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.
11. Reduced to achieve a 50 percent present-value reduction.
12. Reduced to achieve a 67 percent present-value reduction, under the DSR option for the stock operation, the interest rates is slightly higher, reflecting the three-year grace period.
13. Reduced to achieve an 80 percent present-value reduction.
14. The reduction of present value depends on the reduction in interest rates and therefore varies. See footnote 8.
15. In 2003, Paris Club creditors agreed on an new approach, called the Evian approach, to deal with non-HIPC countries. In this context, the Paris Club aims at taking into account debt sustainability consider-

---

**Note:** The table continues with more detailed information on the implementation of various terms and options as per the Paris Club agreements. The text above provides the necessary context for understanding the table.
all or part of its external debt. It may be undertaken on the secondary market or through negotiations with creditors.

**Debt conversion**

**8.33** 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**

**8.34** Prepayments consist of a repurchase, or early payment, of debt at conditions that are agreed upon between the debtor and the creditor, i.e., debt is extinguished in return for a cash payment agreed upon 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. In addition, debtors may enter the secondary market and repurchase their own debt because market conditions are such that it is advantageous financially to do so. However, debt reduction arising from this latter type of buyback is not considered debt reorganization and should not be recorded in the debt reduction Table 8.1 unless the transaction is agreed upon between the debtor and the creditor (see paragraph 8.39).

**Recommended treatment**

**External debt position**

**8.35** 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**

**8.36** 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 between the value of the debt being extinguished and the corresponding claims or funds provided is recorded as a valuation change in the integrated IIP statement (as well as in the integrated external debt position statement—the statement that emphasizes how changes in the position result from transactions, valuation changes, and other changes in volume during the reference period—see Table 7.15). For instance, if the market value of the equity is lower than the value of the old debt, a valuation adjustment is recorded in the integrated position statement under the instrument that is being extinguished. 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 (a capital transfer) 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**

**8.37** Where official debt is exchanged for equity or counterpart funds to be used for development purposes, the difference between the value of the
Debt Reorganization

8.38 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.

8.39 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.

8.40 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).

Debt Assumption

8.41 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. The activation of a guarantee is an example of debt assumption. If the original debtor defaults on its debt obligations, the creditor may invoke the contract conditions permitting the guarantee from the guarantor to be called. The guarantor unit then must either repay the debt or assume responsibility for the debt as the primary debtor and the liability of the original debtor is extinguished. Governments can be the debtor that is defaulting or the guarantor—the unit that must assume responsibility for the debt in case of default.

Recommended treatment

External debt position and debt reduction

8.42 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.

8.43 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. 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. The recording of positions depends on whether the two entities—the entity assuming the debt and the original debtor—are located in the same economy or not, and whether or not the entity that assumes the debt receives a financial claim on the original debtor in respect of the debt that has been assumed. In many cases it is likely that the entity assuming the debt and the original debtor are resident in the same economy. If the original and new debtors are from
different institutional sectors in the same economy, 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; however, the gross external debt position of the economy remains unchanged.

8.44 However, if the assuming entity is in a different economy from the original debtor, then the external debt of the assuming economy (new debtor) is increased, and the external debt of the original debtor reduced by the full amount of the outstanding debt that is assumed. The terms of the debt assumption may include a legal obligation for the original debtor to pay back to the new debtor the amount of debt assumed. If so, the original debtor economy would record this new liability in the external debt position, under the relevant debt instrument(s), and thus its gross external debt position would remain unchanged. If no claim was established, then no new liability is recorded in the external debt position of the original debtor. Every transfer of liabilities between a quasi-corporation and its owner is reflected in the value of its equity stake.

Flow data

8.45 If the entity assuming the debt and the original debtor are resident in the same economy, then no balance of payments transactions are recorded. If both entities are resident in different economies, the debt-assuming economy would record the creation of the new liability to the creditor. Thereafter, the transactions in the balance of payments depend upon whether the assuming economy obtains a claim on the original debtor and, if not, the relationship between the two entities—whether the original debtor was in a direct investment relationship with the entity in the assuming economy or not. If a claim on the original debtor is established, the new debtor records an increase in a debt claim on the original debtor. If no claim is established, a capital transfer (debt forgiveness) from the assuming debtor economy to the original debtor economy is recorded, unless the new and original debtors are in a direct investment relationship, under which circumstances an increase (or decrease) in equity is recorded. The DRS system will record a transfer of liability as the reduction in the stock position of the original debtor and an increase in the stock position of the new debtor, if the entity assuming the debt and the original debtor are resident in the same economy. If both entities are resident in different economies, and a claim is established between the original and the new debtor, the debt assumption will be recorded in the original debtor's economy as a reduction in the stock position of the amount owed to the original creditor and an increase in the stock position of the new creditor. DAC statistics include guarantees—when they are invoked—as debt assumption.

Presentation of Data on Debt Reduction

8.46 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 debt securities.

8.47 Also, data could be presented by type of debt reorganization under which the debt reduction was given: (1) debt rescheduling; (2) debt forgiveness; (3) debt conversion and debt prepayments; and (4) debt assumption. Where a debt-relief package includes elements of more than one type, separately identifying each type is encouraged, e.g., 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,

---

16 The debt-assuming economy would record an increase in its financial assets by the same amount.
17 If the original debtor was in a direct investment relationship with the entity in the assuming economy, an increase in the direct investor's equity (or decrease if the parent is the original debtor) would be recorded in the direct investment enterprise.
18 Unless the original debtor no longer exists, in which case the original debt of the debtor to the creditor is written off in both their accounts (an other volume change is recorded in the IIP statement), a capital transfer from the debt-assuming party to the creditor is recorded as the corresponding entry to the creation of the liability.
19 See BPM6, paragraphs 8.42–8.45 and A2.48–A2.53, for a description of these transactions.
20 In DAC statistics, the public sector in a donor country can provide guarantees to the private sector within the donor country. If the guarantee is invoked, then the official sector takes over the debt and can count this as ODA (depending on debt relief provided).
all debt reduction should be included along with the dominant type of reorganization in the package.

8.48 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.

8.49 Debt reorganization might also be phased over a period of time, such as under multiphase contracts, 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.\(^{21}\)

8.50 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).

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

8.52 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, shown in Box 8.2, 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, i.e., 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 Related to Debt Reorganization

Borrowing for Balance of Payments Support

8.53 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.\(^{22}\)

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. Such borrowing is not considered debt reorganization because it does not alter the terms established for servicing an existing debt.

New Money Facilities

8.54 Some debt-reorganization packages feature new money facilities (new loan facilities that may be used for the payment of existing debt-service obligations). Nevertheless, as these new loan facilities do not alter the terms established for servicing an existing debt, these loans are not considered debt reorganization. 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.

Debt Payments on Behalf of Others

8.55 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

\(^{21}\) In DAC statistics the debt reduction is recorded when the bilateral agreement legally comes into force.

\(^{22}\) Borrowing for balance of payments support is described more fully in BPM6, paragraphs A1.14 and A1.15.
being taken over. In this case, the debt stays recorded solely in the balance sheet of the other institutional unit, the only legal debtor. As the existing debt remains extant, and the terms remain unaltered, this is not considered debt reorganization, and the debt remains external debt of the economy if the creditor is a nonresident. Such a situation may occur where the debtor is experiencing temporary financial difficulties rather than permanent financial problems.

8.56 If the transfer provided to repay the debt creates a new liability 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 quasicorporation of the government). As with debt assumption, a capital transfer or direct investment–equity transaction is recorded if no claim is established by the paying economy. The payment of the debt service is not recorded as a payment of interest or principal by the paying economy because the payments are not related to a liability in its balance sheet.

**Defeasance**

8.57 Defeasance is a technique by which a debtor exactly matches debt service outflows from a set of its liabilities with financial assets with the same debt service inflows, and removes both the asset and liabilities from its balance sheet. Although a debtor may wish to regard the defeased debt as being effectively extinguished, the Guide does not recognize defeasance as affecting the debt of the debtor as long as there has been no change in the legal obligations of the debtor, i.e., the debt should continue to be shown on the gross external debt position. If a separate unit is created to hold the assets and liabilities, the outstanding external debt position of the original debtor economy is reduced, if the second unit is resident of another economy. In this case, the transactions by which the assets and liabilities are moved to the second institutional unit are recorded in the balance of payments. If the two units are resident in the same economy but are classified in different sectors, while the gross external debt position remains unchanged, the sector classification of the debtor changes (a reclassification in other changes in volume account is recorded).

**Debt Write-Offs**

8.58 A creditor can unilaterally decide to write off debt owed to it, and so no longer carries it on its books. This unilateral action arises, for instance, when the creditor regards a claim as unrecoverable, perhaps because of bankruptcy of the debtor. As mentioned in paragraph 8.4, this is not debt reorganization as defined in the Guide because it does not involve a bilateral arrangement. The creditor records the reduction in its financial assets and the debtor records the corresponding debt liability reduction in its external debt position. No transactions are recorded, and the change in positions in both, the external debt position of the debtor economy as well as the external financial assets position of the creditor economy, is accounted for through “other changes in volume” in the reconciliation of gross external debt positions at two different reference dates. A failure by a debtor economy to honor its debt obligations (default, moratorium, etc.) is also a unilateral decision that is not considered debt reorganization (see paragraph 8.4). However, in contrast to debt write-offs, such failure involves no debt reduction in the external debt position of the debtor country, and gives rise to arrears.