# ~~Appendix~~ Annex 2

# Debt Reorganization and Related Transactions

## A. Debt Reorganization

Reference:

IMF and others, *External Debt Statistics: Guide for Compilers and Users*, Chapter 8, Debt Reorganization.

IMF, *Government Finance Statistics Manual 2014*, Appendix 3, Debt and Related Operations.

**A2.1** This ~~appendix~~annex discusses various forms of debt reorganization and related transactions, and how they are recorded in the external accounts~~balance of payments and the international investment position~~. References are made, where applicable, to exceptional financing when reorganization may arise to finance ~~balance of payments~~BOP needs, and to debt concessionality when reorganization may involve transfers to account for such concessionality. Table A1.1 in ~~Appendix~~ Annex 1, Exceptional Financing Transactions, provides a summary presentation of the recording of debt reorganization in the standard and analytic presentations of the ~~balance of payments~~BOP.

**A2.2** *Debt reorganization (also referred to as debt restructuring) is defined as an arrangement~~s~~ that involv~~ing~~es both the creditor and the debtor (and sometimes third parties) ~~that~~in alter~~ing~~ the terms established for servicing an existing debt.* 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.

**A2.3** Debt reorganization usually involves relief for the debtor from the original terms and conditions of debt obligations it has entered into. This may be in response to liquidity issues, where the debtor does not have the cash to meet looming debt service payments, or sustainability issues, where the debtor is unlikely to be able to meet its debt obligations in the medium term.

**A2.4** A failure by a debtor economy to honor its debt obligations (default, unilateral moratorium, etc.) is not debt reorganization because it does not involve an arrangement between the creditor and the debtor.

Such failure gives rise to arrears, which are also covered in this ~~appendix~~annex. Similarly, a creditor can reduce the value of its debt claims on the debtor in its own books through debt write-offs—unilateral actions that arise, 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. Again, this is not debt reorganization as defined in the *Manual*.

**A2.5** The four main types of debt reorganization are:

(a) 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*.

(b) 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.[1] Depending on the nature of the transaction undertaken, the reorganization is described as *debt rescheduling or refinancing* (or debt exchange).

(c) 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, debt-for-development swaps, and debt-for-nature swaps,[2] and *debt prepayment (*or *debt buy-backs for cash)*.

(d) *Debt assumption and debt payments on behalf of others* when a third party is also involved.

**A2.6** A debt reorganization package may involve more than one of the types mentioned above; 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 cancelled.

[1]Also called ~~“time value of money” or~~ “discounted cash flow,” present value is the value today of a future payment or stream of payments discounted at some appropriate compounded interest rate.

[2]Some agreements described as debt swaps are equivalent to debt forgiveness from the creditor and the debtor viewpoint. At the same time, there is a commitment from the debtor country to undertake a number of development, environment, etc., expenses. These transactions should be considered under debt forgiveness, because no value is provided to the creditor.

# 1. Debt forgiveness

## *a. Definitions*

**A2.7** ~~"~~*Debt forgiveness*~~"~~ *(or debt cancellation) is defined as the voluntary cancellation of all or part of a debt obligation within a contractual arrangement between a creditor and a debtor.*[3] *In contrast to debt write-offs, debt forgiveness arises from an agreement between the parties to the debt with the intention to convey a benefit to the debtor, rather than unilateral recognition by the creditor that the amount can no longer be collected.* ~~Debt forgiveness is distinguished from debt write-off by the agreement between the parties and the intention to convey a benefit, rather than unilateral recognition by the creditor that the amount is unlikely to be collected.~~ Debt forgiveness is unlikely to arise between commercial entities. Debt forgiven may include all or part of the principal outstanding, inclusive of any accrued 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.

## *b. ~~Accounting for~~Treatment of debt forgiveness*

**A2.8** In the ~~balance of payments~~BOP, debt forgiveness, as noted in paragraphs A1.5–A1.6, is recorded (at the time specified in the agreement that the debt forgiveness takes effect) in the standard presentation as a capital transfer receipt of the debtor economy (transfer payment of the creditor economy), with a repayment of the debtor's liability in the financial account (a receipt in the creditor's asset). (See Table A1.1, rows 6–11.) In the IIP, the debtor's liability and creditor's asset are reduced by the amount of debt that is forgiven. As to the value of the debt forgiveness, market prices are the basis of valuation for flows and stocks, except for loans where the nominal value is used.

**A2.9** In the analytic presentation, the recording, or not, of debt forgiveness in exceptional financing (below-the-line) depends on whether the debt is due for payment in the current period, in arrears, or not yet due (Table A1.1, rows 1–6). Forgiveness of obligations due in the current period is recorded below-the-line as a

[3] This includes forgiveness of some or all of the principal amount of a credit-linked note arising from 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, such as forgiveness in the event of a type of catastrophe.

credit item under debt forgiveness, whereas the reduction of the obligations is shown above-the-line as a debit item. For forgiveness in arrears from previous periods, a credit entry under debt forgiveness and a debit entry under cancellation of arrears are both recorded below-the-line under exceptional financing. If the obligations not yet due are forgiven, there are no entries under exceptional financing; all entries are above-the-line.

# 2. Debt rescheduling and refinancing

**A2.10** Debt rescheduling and refinancing involve a change in an existing debt contract and replacement by a new debt contract, generally with extended debt service payments. Debt rescheduling involves rearrangements on the same type of instrument, with the same principal value and the same creditor as with the old debt. Refinancing entails a different debt instrument, generally at different value, and may be with a creditor different than that from the old debt.[4] For instance, a creditor may choose to apply the terms of a Paris Club agreement either through a debt rescheduling option (that is, changing the terms and conditions of its existing claims on the debtor) or through refinancing (making a new loan to the debtor that is used to repay the existing debt).

## *a. Debt rescheduling*

***Definition***

**A2.11** *Debt rescheduling is an arrangement that involves the formal deferment of debt service payments and the application of new and generally extended maturities to the deferred amounts~~a bilateral arrangement between the debtor and the creditor that constitutes a formal deferment of debt service payments and the application of new and generally extended maturities~~.* The new terms 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. 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

[4]From the debtor perspective, debt refinancing may involve borrowing from a third party to repay a creditor. The definition of debt refinancing in the *Manual* is a narrower concept reflecting transactions between the debtor and same creditor only. The transactions associated with borrowing from a third party for ~~balance of payments~~BOP support are set out in Section D, Borrowing for Balance of Payments Support, of ~~Appendix~~ Annex 1, Exceptional Financing Transactions.

the time the arrangement becomes effective could be classified as either an effective change in the contractual rate of interest or a reduction in principal with the contractual rate unchanged. Such a reduction in the principal payment to be made at maturity should be recorded as debt forgiveness, or debt rescheduling if the bilateral agreement explicitly acknowledges a change in the contractual rate of interest. Under Paris Club arrangements, rescheduling can be characterized as “flow” or “stock” rescheduling. A flow rescheduling refers to a rescheduling of specified debt service falling due during a certain period and, in some cases, specified arrears outstanding at the beginning of that period.[5] A stock rescheduling refers to rescheduling the outstanding stock of debt at a particular point in time.

***~~Accounting for~~Treatment of debt rescheduling***

**A2.12** The ~~balance of payments~~BOP treatment for debt rescheduling is that the existing contract is extinguished and a new contract created. The applicable existing debt is recorded as being repaid and a new debt instrument (or instruments) created with the new terms and conditions. In the standard presentation for the debtor, a debit entry is recorded under the appropriate instrument representing the repayment of the old debt with a credit entry under the appropriate instrument representing the creation of a new debt (Table A1.1, rows 19–25). This treatment does not apply, however, to interest arrears that are being rescheduled when the conditions in the existing debt contract remain intact. In such a case, the existing debt contract is not considered to be rescheduled, only the interest arrears. The IIP reflects the transactions extinguishing the old debt instrument and creating the new instrument. If the debt rescheduling includes an element of debt forgiveness (e.g., part of principal outstanding and/or any accrued interest arrears), then a capital transfer would be recorded as the difference in the value of the contracts.

**A2.13** The transaction is recorded at the time both parties record the change in terms in their books~~, and is valued at the value of the new debt (which, under a debt rescheduling, is the same value as that of the old debt)~~. If no precise time is determined, the time at which the creditor records the change in terms 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

[5] In the ~~balance of payments~~BOP, if the debt falling due during the period is rescheduled, the transaction is treated the same as the rescheduling of a debt stock.

in the ~~balance of payments~~BOP only in the period when the specified conditions are met.

**A2.14** In the analytic presentation, as noted in ~~Appendix 1~~Annex 1, Exceptional Financing Transactions, the recording of debt rescheduling transactions in exceptional financing depends on whether the debt being rescheduled is due for payment in the current period, in arrears, or not yet due. Obligations falling due in the reporting period are recorded under exceptional financing (below-the-line as credit entries under the appropriate instruments), with debit entries made above-the-line under the appropriate debt instruments in the financial account and the income account (for accrued interest) (Table A1.1, rows 19–22). For arrears, the two entries are under exceptional financing, that is, below-the-line, with credit items (under the relevant instrument) and debit items (under rescheduling of arrears) (Table A1.1, rows 23–24). For obligations not yet due, both debit and credit entries are recorded above-the-line under the appropriate instruments in the financial account (Table A1.1, row 25).

## *b. Debt refinancing*

### *Definition*

**A2.15** *Debt refinancing is an arrangement that involves the replacement of an existing debt instrument or instruments, including any arrears, with a new debt instrument or instruments.* It can involve the exchange of the same type of debt instrument (e.g., loan for a loan) or different types of debt instruments, for example a ~~(~~loan for a bond or the consolidation of~~). For instance, the public sector may convert~~ various export credit debts into a single loan. Also, debt refinancing can be said to have taken place when a debtor exchanges existing bonds for new bonds through exchange offers given by its creditor (rather than a change in terms and conditions). So debt refinancing can occur irrespective of whether the debtor is experiencing ~~balance of payments~~BOP difficulties or not.

### ***~~Accounting for~~Treatment of debt refinancing***

**A2.16** The ~~balance of payments~~BOP treatment of debt refinancing transactions is similar to debt rescheduling to the extent that the debt being refinanced is extinguished and replaced with a new financial instrument or instruments. However, unlike in rescheduling, the old debt is extinguished at the value of the new debt instrument

except for nonmarketable debt owed to official creditors.

**A2.17** If the refinancing involves direct debt exchange, such as a loan-for-bond swap, in the standard presentation, debit entries are recorded by the debtor under the appropriate debt instrument in the financial account and the income account (for accrued interest) and a credit entry under portfolio investment liabilities to show the creation of the new obligation (Table A1.1, rows 26–30). The transaction is valued at the value of the new debt with the difference between the value of the old debt and that of the new instrument recorded in the revaluation account. However, if the debt is owed to official creditors and is nonmarketable (loan), the old debt is extinguished at its original value with the difference in value with the new instrument recorded as debt forgiveness.

**A2.18** Where there is no established market price for the new bond, an appropriate proxy is used. For example, if the bond is similar to other bonds being traded, the market price of a traded bond would be an appropriate proxy for the value of the new bond. If the debt being swapped was recently acquired by the creditor, the acquisition price would be an appropriate proxy. Alternatively, if the interest rate on the new bond is below the prevailing interest rate, the discounted value of the bond, using the prevailing interest rate, could serve as a proxy. If such information is not available, the face value of the bond being issued may be used as a proxy. See also debt-for-equity conversion below.

**A2.19** The IIP reflects the transactions extinguishing the old debt instrument and creating the new debt instrument along with any valuation change recorded in the revaluation account. For instance, a loan-for-bond exchange undertaken will generally result in a reduction in the liabilities of the debtor (reduction in the claim of the creditor on the debtor economy) because the loan is recorded at nominal value versus the market value of the bond.

**A2.20** In the analytic presentation, debt-for-bond exchange of obligations falling due in the reporting period are recorded below-the-line as credit entries under the appropriate instruments in exceptional financing, with debit entries made above-the-line under the appropriate debt instruments in the financial account and the income account (for accrued interest) (Table A1.1, rows 26–27). For arrears refinanced, there are offsetting credit (under the relevant instrument) and debit items (under rescheduling of arrears) under exceptional financing. For obligations not yet due, both debit and credit entries are recorded above-the-line under the appropriate instruments in the

financial account (Table A1.1, row 30). When arrears are cancelled as a result of a debt-for-debt exchange, the two entries are below-the-line: a debit entry under cancellation of arrears (under the relevant debt instrument in the standard presentation) and a credit item under debt forgiveness (Table A1.1, rows 28–29).

**A2.21** If the proceeds of the new debt are used to partially pay off existing debt, any remaining debt is recorded as the extinguishment of the old debt and creation of a new debt, unless it is paid off through a separate transaction.

**A2.22** If the terms of any new borrowings are concessional, the creditor could be seen as providing a transfer to the debtor. Debt concessionality is discussed below.

# 3. Debt conversion and debt prepayment

## *a. Definitions*

**A2.23** *Debt conversion (swap) is an exchange of debt —(typically at a discount) —for a nondebt claim such as equity, or for counterpart funds that can be used to finance a particular project or policy.* Typically, debt conversion involves an exchange of external debt in foreign currency for a nondebt obligation in domestic currency, at a discount. Debt for equity, debt for exports, debt for nature, and debt for development swaps are all examples of debt conversion. In essence, external debt is extinguished and a nondebt liability created.

**A2.24** A debt-for-equity swap results in reduced debt liability and an increase in equity liability of the debtor economy. A third party, usually a nongovernmental organization (NGO) or a corporation, is often involved in a debt-for-equity swap, buying the claims from the foreign creditor and receiving shares in a corporation or local currency (to be used for equity investment) from the debtor economy.

**A2.25** 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.

**A2.26** It is important to distinguish direct and indirect debt conversion, that is, whether the swap leads directly to the acquisition of a nondebt claim on the debtor, or indirectly via another claim on the economy, such as a deposit that is subsequently used to purchase equity.

## b. ~~Accounting for~~Treatment of debt conversion

**A2.27** Where debt is exchanged for another item (e.g., equity or counterpart funds for development purposes), the transaction is recorded at the time both parties record the exchange of value in their books. The general principle is for the old debt to be valued at the value of the item acquired (converted at the prevailing market exchange rate if the item is in foreign currency). Any difference between the value of the debt being extinguished and the corresponding claim or funds provided is recorded as a valuation adjustment in the revaluation account. An exception arises when official creditors are owed nonmarketable debt, and the counterpart claim (assets) has a lower value than the debt, in which case the transaction in the old debt is recorded at its full value and any difference in value between the debt and counterpart item (or assets) is recorded as debt forgiveness, a capital transfer. With debt-for-development swaps, the transactions recorded should be based on the type of debt obligation forgiven rather than the subsequent use of the funds.

**A2.28** Debt-for-equity and debt-for-development swaps are the most commonly used debt conversion arrangements.

## c. Debt-for-equity swaps

### *Direct debt conversion*

**A2.29** For debt exchanged directly for equity investment in the debtor economy, credit entries should be made under direct investment–equity, or portfolio investment–equity. These transactions should be recorded at the value of the equity acquired, with offsetting debit entries made under the appropriate debt instrument for the reduction in liabilities. The treatment of transactions recorded depends on whether the debt being swapped is due for payment in the current period, is in arrears, or is not yet due (Table A1.1, rows 8–11).

### *Debt due for payment in the current period*

**A2.30** In the standard presentation, for a debt-for-equity swap there are debit entries under the relevant instrument, such as other investment liabilities, and the income account (for accrued interest) for all payments falling due in the current period. The value of the repayment of the old debt is equal to the market value of the equity liability being swapped, with the contra-entry credit recorded in direct investment–equity, or portfolio

investment–equity. If the market value of the new liability is lower than the value of the old debt, a valuation adjustment is recorded under the relevant instrument, such as loan liabilities in the revaluation account (see also paragraph A1.13).

**A2.31** In the analytic presentation, the debit entries are recorded above-the-line and the contra-entry credit is recorded below-the-line under direct investment or portfolio investment-equity.

***Debt in arrears***

**A2.32** In the standard presentation, debt-for-equity swaps for arrears are recorded as a debit entry under the relevant instrument in the financial account, at the value of the equity liabilities being provided, with the contra-entry credit in direct investment–equity or portfolio investment–equity. In the analytic presentation, a debit entry is recorded in exceptional financing under cancellation of arrears, with the offsetting credit entry also recorded in exceptional financing under direct investment-equity or portfolio investment-equity.

***Debt due for payment in the future***

**A2.33** In the standard presentation, debit entries arising from debt-for-equity swap operations for debt due for payment in the future and exchanged at a price below nominal value are recorded as a debit entry in the respective accounts at the value of the equity liabilities being provided with the contra-entry credit in direct investment-equity, if the direct investor (equity holder) directly holds equity that entitles it to 10 percent or more of the voting power in the direct investment enterprise; otherwise, the equity claim should be recorded under portfolio investment-equity. If the market value of the new liability is lower than the value of the old debt, a valuation adjustment is recorded under the relevant instrument, such as loan liabilities in the revaluation account (see also paragraph A1.13). In the analytic presentation, all entries are made above-the-line as in the standard presentation.

**A2.34** In all cases, in the IIP, equity liabilities (either direct or portfolio) increase and debt liabilities decrease by the value of the instrument extinguished.

***Indirect debt conversion***

**A2.35** A debt-for-equity swap may also involve indirect conversion. An example is when a fixed-payment foreign currency liability (e.g., a debt security or loan) is exchanged at a discount for a domestic financial instrument, such as a domestic currency deposit. The proceeds are then reinvested by the nonresident into the equity of the debtor. These swaps are valued at market prices in the ~~balance of payments~~BOP.

**A2.36** In the standard presentation, this transaction is recorded by the debtor as an increase in liabilities (credit) under the financial instrument provided, with corresponding debit entries under the instrument (liability) being extinguished (Table A1.1, rows 12–16). Subsequently, the nonresident creditor exchanges the financial instrument received for equity investment in an enterprise of the debtor economy. At this point, a credit entry is recorded under direct investment–equity, if the direct investor (equity holder) directly holds equity that entitles it to 10 percent or more of the voting power in the direct investment enterprise; otherwise, the equity claim should be recorded under portfolio investment–equity. The offsetting debit entry is made under the relevant instrument being exchanged for the equity, such as currency and deposits. In the IIP, equity liabilities (either direct or portfolio) increase and debt liabilities decrease by the value of the instrument extinguished.

**A2.37** In the analytic presentation, the treatment is the same as described for direct debt conversion except that only the initial transaction is relevant, so the credit entry is recorded under the relevant financial instrument provided, rather than equity.

## *d. Debt-for-development swaps*

**A2.38** A debt-for-development swap involves the exchange at a discount of an existing liability (e.g., a debt security or loan) for a claim (such as a domestic deposit) earmarked for a specific development purpose in the debtor economy. For example, an NGO purchases debt from the original creditor at a substantial discount using its own foreign currency resources, and then resells it to the debtor country government for local currency equivalent. The NGO in turn spends the money on a development project, previously agreed on with the debtor country government.

**A2.39** In the standard presentation, the debtor economy records the transaction only with the creditor (such as an NGO). The debtor records an increase in liabilities (credit) under the appropriate debt

instrument provided to the creditor, with an offsetting debit entry recorded under the appropriate debt instrument being extinguished (Table A1.1, rows 39–43). In the IIP, liabilities decline by the value of the debt extinguished and increase by the value of the other claim provided that it is still outstanding at the end of the period.

**A2.40** If a debt-for-development swap is undertaken to meet a ~~balance of payments~~BOP need (see paragraphs A1.2-A1.3), only the initial transaction with the creditor is relevant for the analytic presentation. Subsequent use by the creditor of the assets acquired for development in the debtor economy is not exceptional financing—the credit items are recorded as capital transfers (Table A1.1, row 43).

## *e. Debt prepayment*

### *Definitions*

**A2.41** *Debt prepayments consist of ~~a~~ repurchases, or early payments, 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." Debt prepayment could be driven by the debtor's need to reduce the cost of its debt portfolio by taking advantage of favorable economic performance or market conditions to repurchase debt, or for ~~balance of payments~~BOP purposes, such as a looming ~~balance of payments~~BOP constraint.

### ***~~Accounting for~~Treatment of debt prepayment***

**A2.42** In the standard presentation, debit entries relating to debt prepayment are recorded by the debtor in the appropriate instrument in the financial account when the transactions take place at the value of the debt prepaid. Credit entries are recorded in reserve assets or in currency and deposits in *other investment*–assets depending on the source of financing. In the IIP, the debtor's liability declines by the amount of debt prepaid. As noted in ~~Appendix~~ Annex 1, Exceptional Financing Transactions, if prepayment of debt is linked to ~~balance of payments~~BOP needs and is financed from reserve assets, both credit and debit items are recorded below-the-line in exceptional financing and reserve assets, respectively (Table A1.1, rows 31–32). Prepayments of debt using debtor's own financial assets other than reserve assets is recorded above-the-line as in

standard presentation (Table A1.1, row 33). If the debt is owed to official creditors and is nonmarketable (loan), some element of debt forgiveness could arise—that is, if the prepayment occurs within an agreement between the parties with an intention to convey a benefit (see paragraph A2.7).

**A2.43** In the analytic presentation, debt prepayment transactions are recorded as exceptional financing only if they are financed from reserve assets for the ~~balance of payments~~BOP purposes of the debtor economy. In this case, debit entries are recorded below-the-line in the appropriate instrument in exceptional financing with offsetting credit entries in reserves recorded below-the-line.

**A2.44** If the prepayment was financed from external donor funds, transactions could result in a two-stage analysis if cash is provided to the debtor economy that subsequently uses the proceeds to prepay the debt.

***Stage 1***

**A2.45** The debtor economy records in the standard presentation a credit entry under capital transfers in the capital account equal to the donor funds provided. An offsetting debit entry is recorded in reserves assets. In the analytic presentation, the debtor economy records a credit entry below-the-line under transfers in exceptional financing, with the offsetting debit entry recorded in reserve assets.

***Stage 2***

**A2.46** When the debt prepayment occurs, the debtor economy records in the standard presentation the repayment of the debt instrument as a debit entry at the value paid, with an offsetting credit entry in reserve assets. In the analytic presentation, the debit entry is recorded under the relevant debt instrument below-the-line[6] and the credit entry under reserve assets. Savings arise in future years as a result of the prepayment of the debt. The debit entry is recorded below-the-line as the transaction affects reserve assets in the reporting period.

**A2.47** In the IIP of the debtor economy, assets increase in the first stage and decline, along with debt liabilities, when the prepayment takes place.

[6] Advance payments for ~~balance of payments~~BOP need are recorded below-the-line (see ~~Appendix~~ Annex 1, Exceptional Financing Transactions).

# 4. Debt assumption and debt payments on behalf of others

## *a. Debt assumption*

***Definition***

**A2.48** *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 debt*. Calling 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. Also, a government through agreement can offer to provide funds to pay off the debt obligation of another government owed to a third party.

***~~Accounting for~~Treatment of debt assumption***

**A2.49** The amount of the debt to be recorded is the full amount of the outstanding debt unless there is an agreement with the creditor to reduce the amount of debt owed. The timing of the recording is at the time the debt is removed from the original debtor's balance sheet.

**A2.50** In the standard presentation the transaction recorded between the creditor and debtor is as described in paragraphs [8.42–8.45] and Box 8.1. The creditor records a new ~~loan~~ debt claim on the new debtor. The extinguishing of the original debt is classified as a transaction if the original debtor continues to exist, or as other volume change (with a capital transfer recorded from the new debtor to the creditor) if the original debtor no longer exists.

**A2.51** In many cases it is likely that the entity assuming the debt and the original debtor are resident in the same economy, such as the case of a government assuming the debt of a resident entity. In such instances, the sector classification of the debtor may change.

**A2.52** However, if the assuming entity was in a different economy from the original debtor was, then the nature of the transactions recorded would depend on whether the assuming economy obtained a claim on

the original debtor and, if not, the relationship between the two entities. The terms of the debt assumption may include a legal obligation for the defaulting entity to pay back to the guaranteeing unit the amount of debt assumed. If so, in the standard presentation, the original debtor economy would record both credit and debit entries under the relevant debt instrument(s) in the financial account. If no claim was established, then a capital transfer (debt forgiveness) would be recorded from the assuming to the original debtor economy. However, if the original debtor was in a direct investment relationship with the entity in the assuming economy, ~~in which instance~~ 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. If the new debtor acquires a claim that only partially covers the debt acquired, the difference is classified as debt forgiveness by both the original and new debtors. If the original debtor no longer exists, an other volume change is recorded, as described in paragraph A2.50.

**A2.53** In the analytic presentation, if the new debtor and original debtor are resident in different economies, the recording of debt assumption is the same as for debt rescheduling if the new debtor acquires a claim on the original debtor. If not, then the recording of the debt assumption is the same as for debt forgiveness (except in the case of direct investment as described in the previous paragraph). When a partial claim is acquired, the recording as between debt rescheduling and debt forgiveness is prorated accordingly.

## *b. Debt payments on behalf of others*

### *Definition*

**A2.54** 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. As the existing debt remains extant, and the terms remain unaltered, this is not considered debt reorganization. Such a situation may occur where the debtor is experiencing temporary financial difficulties rather than permanent financial problems.

### ***~~Accounting for~~Treatment of debt payments on behalf of others***

**A2.55** As with debt assumption, the recording of transactions depends on whether the two entities are located in the same economy or not, and whether or not the payer receives a financial claim on the debtor in respect of the debt service payments it has made on behalf of the debtor.

**A2.56** If the paying entity and the original debtor are resident in the same economy, then no ~~balance of payments~~BOP transactions are reported between them. If they are in different economies, and a claim is established on the original debtor, the paying economy records an increase in financial assets and a decrease in reserve assets or currency and deposits, depending on the source of funding. Otherwise, as with debt assumption, a capital transfer or direct investment–equity transaction is recorded. 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.

**A2.57** If a financial claim has not been established, and the transactions arise from a ~~balance of payments~~BOP need, in the analytic presentation the debtor country records a credit entry below-the-line in transfers (other intergovernmental grants) under exceptional financing and a debit entry above-the-line reflecting any interest and principal payments made.

# 5. Special cases

## *a. Debt service falling due between Paris Club agreed minutes date and specified implementation date*[7]

**A2.58** Under Paris Club debt rescheduling arrangements, creditor countries as a group usually agree in the nonbinding "Agreed Minutes" 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.

**A2.59** When such payments fall due, they are considered technical arrears (*External Debt Statistics:*

[7]The guidance in this section is based on the Paris Club arrangements because the issue described most commonly arises in that forum. But the guidance is equally applicable to other fora in which the same issue arises.

*Guide for Compilers and Users*, paragraph 3.~~37~~44). Given that there is a mutually signed understanding between the debtor and the creditor that the terms and conditions in the mother agreement are temporarily suspended, technical arrears are treated in the standard presentation of the debtor economy as rescheduled short-term debt and classified under other investment, other accounts receivable/payable, until the effective date of the bilateral agreement when the new terms apply.[8] When the new terms apply, there may be a need to reclassify technical arrears to the appropriate instruments in the financial account.

**A2.60** In the analytic presentation, debit entries are recorded above-the-line as in the standard presentation, while corresponding credit entries are recorded below-the-line as accumulation of arrears, in exceptional financing.

### *b. Debt service moratorium extended by creditors*

**A2.61** Debt service moratorium 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 when a debtor has difficulties in servicing its debt (e.g., in the event of natural disasters or other crises), such as the moratorium granted to less developed countries under the G20 Debt Service Suspension Initiative during the COVID-19 pandemic~~tsunami-affected countries in 2005~~, and usually involves formal exchange of letters (e.g., consent solicitation) but not necessarily a formal bilateral agreement.

**A2.62** 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. In the standard presentation for the debtor, a debit entry is recorded under the appropriate instrument representing the repayment of obligations as they fall due with a credit entry under the same instrument representing the creation of a new debt. In the analytic presentation of the debtor economy, debit entries of obligations falling due in the current period are recorded above-the-line, and contra-entries are recorded as rescheduling of existing debt under other investment liabilities in exceptional

[8] This approach is applicable to other debt rescheduling arrangements with similar terms.

financing.

# B. Other Debt-Related Transactions and Arrangements Transactions Related to Debt Reorganization

## 1. New money facilities

**A2.63** In some debt reorganization arrangements to assist the debtor to overcome temporary balance of paymentsBOP difficulties, new money facilities are agreed with the creditor to be used to repay maturing debt obligations. In the standard presentation, drawings on the new money facilities are recorded by the debtor as a credit, and offsetting debit entries are made under the appropriate instrument, such as reserve assets. As the maturing debt obligations are paid, debit entries are recorded under the debt instrument for principal amounts falling due and under income for interest accrued in the current period. In the IIP the liabilities (assets) of the debtor (creditor) are increased by the new borrowing.

**A2.64** In the analytic presentation, a credit entry for the full amount borrowed is recorded under drawings on new loans within exceptional financing, with the offsetting debit entry under reserve assets. Scheduled debt payments out of the proceeds of the new borrowings are not regarded as exceptional financing; that is, debit entries are made above-the-line and offsetting entries under reserve assets, but advance repayments of debt for balance of paymentsBOP purposes from reserve assets are recorded as debit items under exceptional financing under the relevant financial instrument. If the terms of the new borrowings are concessional, the creditor is providing a transfer to the debtor. Debt concessionality is discussed below.

## 2. Defeasance

**A2.65** 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 (see paragraphs 8.30–8.31). Although a debtor may wish to regard the defeased debt as being effectively extinguished, the *Manual* 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. With defeasance, a debtor unit removes

**Commented [A1]:** This text has been replaced by the text in paragraph A3.37 of the *GFSM 2014* to achieve better flow and ensure maximum consistency with other macroeconomic statistical standards. The idea is that Annex 2 of *BPM7* will be a joint annex with Appendix 3 of the updated *GFSM* with as much common language as possible (similar to the approach taken for the joint *BPM7/2008 SNA* chapters).

liabilities from its balance sheet by pairing them with financial assets, the income and value of which are sufficient to ensure that all debt-service payments are met. Defeasance may be carried out by placing the assets and liabilities in a separate account within the institutional unit concerned or by transferring them to another unit (see paragraphs [8.30–8.31]). In either case, the macroeconomic statistical systems do not recognize defeasance as affecting the outstanding debt of the debtor. That is, the debt should continue to be shown on the liabilities side and the financial assets recorded on the asset side of the balance sheet, and the transactions associated with those assets and liabilities recorded in the ~~balance of payments~~BOP provided they are with nonresidents. If a separate unit is created to hold the assets and liabilities, the transactions by which the assets and liabilities are moved to the second institutional unit are recorded in the financial account, if the second unit is resident of another economy. If the two units are resident in the same economy but are classified in different sectors, a reclassification in other changes in volume account is recorded.

## 3. Debt write-offs

**A2.66** A creditor can unilaterally decide to write off debt owed to it (see paragraph [9.9]). No transactions are recorded but the creditor economy records the reduction in its financial assets through the other changes in the volume of assets account. (The corresponding liability should also be removed from the balance sheet of the debtor, through the other changes in volume account.)

## 4. Debt concessionality

Commented [A2]: This subsection has been updated with the conclusions listed on page 10 of the Issue Note - A Holistic Assessment of the Treatment of Concessional Lending in Macroeconomic Statistics

**A2.67** *Concessional loans are loans intentionally provided at a contractual interest rate below market interest rates, for similar grace and repayment periods as equivalent market loans, with the purpose to convey a benefit, occurring in a noncommercial context.* Debt concessionality has gained increasing importance in discussions relating to debt relief to the heavily indebted poor countries. ~~However, there is no consistent definition or measure of debt concessionality in economic accounts. In debt reorganization through the Paris Club, such as the Heavily Indebted Poor Countries Initiative and similar arrangements, debt reduction in present value terms is calculated using a market-based discount rate, usually the OECD's Commercial Interest Reference Rate~~

(CIRR).[9] The difference between the nominal value of the applicable debt and its present value is the amount of capital transfer derived from the debt reorganization arrangements.

**A2.68** While the transfer element for concessional lending is not recorded in the central framework of macroeconomic statistics,[10] economies are encouraged to provide these data as supplementary items for concessional loans provided in a nonmarket context (i.e., those provided by governments, central banks, and international organizations). Where such transfers are significant, countries are encouraged to provide these data as a supplementary[11] item to the standard components. TheThis supplementary recording should be made as a one-off transaction capital transfer at the point of loan origination equal to the difference between the present value of the cash flows discounted by the contractual interest rate and thenominal value of the debt and its present value (using a relevant market discount rate such as the OECD's Commercial Interest Reference Rate (CIRR).[12] CIRR). For a new loan, this approach would require information on the market interest rate at inception and the contractual interest rate —with the market interest rate as the discount rate and the difference the value of the transfer. This approach has the advantage of considering all the possible sources of transfers in debt concessionality—maturity period, grace period, frequency of payments, interest rate, and other applicable costs—and reflects that the concessional element relates to an explicit policy decision to provide a lower interest rate at the start of the loanis consistent with nominal valuation of loans. In addition, this approach is consistent with the economic equivalence between a concessional loan of say, 100 units with an embedded grant element of 35 percent, and a commercial loan of 100 units combined with a direct grant of 35 units. The transfer value is calculated at the time it happens, that is, at the inception of the debt, as the difference between its nominal value and its present value using the payment stream and the current market interest rate as the discount factor.

---

[9] These rates are determined on the fifteenth day of each month for applicable currencies on the basis of secondary market yields on government bonds with residual maturity of five three to 10 years and, in addition, three and seven years for the Canadian dollar, the U.S. dollar, and the euro.

[10] The only exception is concessional loans provided by employers to employees, mainly because of a more accurate accounting for remuneration of employees (see paragraph [12.X]).

[11] The advantage of a supplementary item in the accounts as opposed to the main body is that while it allows these transfers to be measured and data disseminated, it would also allow compilers to develop their approaches over time without affecting the main accounts.

[12] These rates are determined on the fifteenth day of each month for applicable currencies on the basis of secondary market yields on government bonds with residual maturity of three to 10 years.

**A2.69** If the loan is retired before maturity and replaced by a new loan, adjustment of the previously recorded transfers is required. This means that the value of any transfers not yet received on the original loan that is replaced would need to be subtracted from the original transfer value calculated; otherwise, the amount of concessionality recorded over time would be overstated.

**A2.70** This can be done by recalculating the transfer at inception using the actual payment schedule outturn, including the retirement of the entire remaining loan at the time of rescheduling.[13] This recalculated value should replace the originally calculated value in the historical supplementary series, so the historical data reflect the actual transfers received and do not mix any new concessional transfer with the value not received on the original loan, when there may have been a different set of market-related interest rates.

# 5. Debt arising from off-market swaps

**~~A3.67~~A2.71** In macroeconomic statistics, swaps give rise to financial derivatives, which are nondebt instruments (see paragraph ~~7.215~~[5.32]). However, off-market swap contracts have a debt component.

**~~A3.68~~A2.72** An off-market swap is a swap contract that has a nonzero value at inception as a result of having reference rates priced differently from current market values—that is, "off-the-market." ~~Such a swap results in a lump sum being paid, usually at inception, by one party to the other.~~ The economic nature of an off-market swap contract is a combination of ~~borrowing~~ a debt (i.e., the ~~lump sum~~nonzero value provided to/from the counterparty at inception), in the form of a loan, and an on-market swap (financial derivative). ~~The loan component of an off-market swap is debt and, i~~If a ~~public sector~~resident institutional unit receives the ~~lump-sum payment~~loan component from a nonresident, this will be part of ~~public sector~~external debt. Examples of swaps contracts that may involve off-market reference rates include interest rate and currency swaps.

**~~A3.69~~A2.73** Because the economic nature of an off-market swap contract is equivalent to a combination of a loan and a financial derivative, two ~~stock~~ positions are recorded in the balance sheet:

- A loan—a debt instrument—which is equal to the nonzero value of the swap contract at inception and with a maturity date equivalent to the expiration date of the swap.
- A financial derivative ~~(swap) component~~—a nondebt instrument—that has a market value of zero at inception.

[13] This retirement value would include any amount that is forgiven because such forgiveness is recorded as a capital transfer in the period given.

**Commented [A3]: This section is based on text from the *GFSM 2014* with only changes compared to the *GFSM 2014* shown in track changes.** The first five paragraphs in this section are based on paragraphs A3.67-A3.71 of the *GFSM 2014* (which are consistent with the text in paragraphs 4.127-4.131 of the *Public Sector Debt Statistics Guide for Compilers 2011 and Users* and paragraph 4.174 of the *MFSMCG 2016*). The last paragraph is based on paragraph 4.175 of the *MFSMCG 2016* and the clarification note on the *Recording of Central Bank Swap Arrangements in Macroeconomic Statistics*. The SNA, GFSM, and MFSMCG editorial teams all agree with the updated text.

In addition, if the swap involves an exchange of principals, this should be recorded at market value in the relevant item (most likely in currency and deposits).

**~~A3.70~~A2.74** The loan position is a liability of the party that receives ~~the lump sum~~it (i.e., the nonzero value of the swap contract at inception), while the derivative position may appear either on the financial asset or liability side, depending on market prices on the balance sheet date.

**~~A3.71~~A2.75** Future streams of flows relating to these ~~stock~~ positions are also partitioned between those relating to the loan and financial derivative component, respectively.

**A2.76** Off-market central bank swap arrangements or other similar arrangements should be treated as an exchange of deposits with maintenance of value without any recordings in financial derivatives (see paragraphs [6.102-6.104]).

**Commented [A4]:** The sentence is based on the example in Box 4.17 of the *Public Sector Debt Statistics Guide for Compilers and Users 2011*.