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BPM5 Rewrite on Financial Derivatives

Prepared by the Statistics Department
International Monetary Fund

BPM5 REWRITE ON FINANCIAL DERIVATIVES

At the Committee meeting in 1998, the Committee agreed to the proposed text for *BPM5* subject to further consideration about separate sub-components for financial derivatives in direct investment and reserve assets. It instructed the Fund to take account of changes in wording based on comments provided by members and then release the document, while noting that the information on direct investment and reserve assets may be subject to further change pending input from the OECD and the ECB.

However, subsequent to the meeting, it was learned that the corresponding rewrite of financial derivatives sections of the 1993 *SNA* would be subject to a lengthy process of review—following agreement in principle at the United Nations Statistical Commission in March 1999, a formal consultation process was undertaken. Because maintaining consistency between *BPM5* and the *1993 SNA* is an important objective, it was decided not to release the *BPM5* rewrite until the *SNA* consultation process was completed. As a consequence of the 1993 *SNA* consultations, a small addition to the text presented to the Committee in October 1998 has been made in regard to the treatment of an implicit service charge in the arrangement of some financial derivatives. The modification is reflected in footnotes 3 and 5. The *1993 SNA* process of consultation is now nearing a close: the *SNA* document has been sent to the members of the United Nations Statistical Commission. If there are no further requests for changes, the *SNA* document will be adopted in December 1999.

While the *1993 SNA* consultation continued, issues regarding the appropriate treatment of financial derivatives in direct investment and reserve assets were also considered. These only bear upon the presentation of balance of payments data, they do not affect the presentation of *1993 SNA* data.

As regards **direct investment**, the meeting of the OECD Foreign Direct Investment (FDI) Workshop of the Working Party on Financial Statistics meeting in March 1999 did not reach a formal position. Rather two views emerged. The first view was that financial derivatives transactions between affiliated enterprises do not belong in FDI and even if they are to be included, derivative transactions between affiliated financial enterprises should be regarded as a form of "regular banking activities" and so be excluded. The second view was that the collection of position data for derivatives would be difficult, as these compilers rely on the balance sheets of direct investors or direct investment enterprises and derivatives are usually (for the present) off-balance sheet items.

The Fund is proposing in the attached rewrite that financial derivatives be separately identified in direct investment with the exception for derivative transactions between affiliated banks and affiliated financial intermediaries, which would be excluded from direct investment. There are two main reasons for this position. First, while the functional category of direct investment

covers all transactions between affiliated direct investment enterprises, except for the "financial intermediaries exception," financial derivatives do not meet the criteria for inclusion in any of the direct investment sub-components—financial derivative instruments are not permanent debt or equity, but neither do they meet the definition of "other capital", the borrowing or lending of funds (*BPM5*, paragraph 371). So for financial derivative transactions to be included in direct investment, a separate sub-component needs to be created. Of course, it might be argued that while direct investment is defined as including all transactions between affiliated direct investment enterprises, the definition of its sub-components indicates that the intent is that only capital raising instruments be included, and that the exclusion of a reference to financial derivatives in the present direct investment chapter of *BPM5* reflects this. Thus, it could be equally argued that all financial derivative transactions should be excluded from direct investment. If the Committee is of this view, the Fund will need to go back to its membership because excluding financial derivatives from direct investment goes beyond the position agreed following the consultation by the Fund with its members in 1997.

The second reason for distinguishing financial derivatives in direct investment is for external debt purposes, that is the need to distinguish traditional debt instruments from financial derivatives. If debt and financial derivatives are included indistinguishably together in the same subcategory, external debt instruments could not be separately identified.

Regarding financial derivatives and **reserve assets**, two issues are raised for the attention of the Committee. Should financial derivatives be included in reserve assets, and, if so, should they be separately identified? In the *BPM5*, financial derivatives are more narrowly defined than in the rewrite—essentially, over-the-counter forward contracts are regarded as financial assets in the rewrite, unlike *BPM5* Õ and are included in reserve assets. Similarly, in the *Data Template on International Reserves and Foreign Currency Liquidity*, that is a prescribed category of the SDDS, allowance is made for the inclusion in reserve assets of the net marked-to-market value of derivatives (section I of the template). The net marked-to-market value of the authorities' financial derivatives positions with both residents and nonresidents is to be reported in section IV of the template (memorandum items).[1]

In the *Provisional Operational Guidelines on the Data Template on International Reserves and Foreign Currency Liquidity*, which are intended to clarify the components of the template and are close to being finalized, it will be proposed that financial derivatives, on a net basis, be recorded in *reserve assets* only if they are for the purposes of management of reserve assets, are integral to the valuation of such assets, and are under the control of the monetary authorities. In addition, these instruments must be highly liquid and settled in foreign currency. This wording is followed in the draft rewrite attached. The changes are to be found in paragraphs 442a and 473a.

[1] The net market-to-market position refers to the marking of derivative positions to market value, and then taking the difference between the market values of gross assets and gross liabilities.

In March, 1999 the Governing Council of the ECB agreed to include a separate category in reserve assets for the net marked-to-market value of financial derivatives. The ECB also justified the inclusion of financial derivatives in reserve assets on the use of these instruments for reserve asset management and on the recent heightened interest in the reserve asset item and its composition. The ECB recognized that including the net value would be an exception to the gross asset concept, but felt that if only gross asset positions were included, it would not be possible to reconcile net flows and positions.

The decision or not to include financial derivatives is finely balanced. On the one hand, some central banks use financial derivatives to maintain the value of their reserves and these instruments are an integral part of reserve asset management. The argument runs that to exclude such financial derivative positions from reserve assets, an arbitrary picture of reserves data would be provided. If financial derivatives are used to protect asset value, it is best they be included on a net basis, because these derivatives may have a negative or positive value depending on how they are used and the changes in market prices relative to the contract price. However, by including the net value of derivatives in reserves, the definition of reserve assets is being extended to cover liabilities. Not least because of the inclusion of liabilities, positions in financial derivatives should be separately identified.

There are other possible approaches. First, derivative asset positions alone could be included. The argument is that derivatives are invariably liquid instruments and so it might be possible to close out an asset position at very short notice by creating an offsetting contract. So, in effect, the asset is quickly realized for cash. Of course, it is debatable whether creating a new contract to offset an existing one, makes the original contract readily available to meet a balance of payments need. Also, the analytical usefulness of including only assets is open to question, as it is tantamount to creating a one-way bet. Until settlement, the use of derivatives could result in the value of reserves rising but not falling, because once a derivative instrument turned negative, it would be excluded. The very arbitrariness mentioned above would be even more evident.

Second, financial derivatives could be excluded from reserve assets. The argument is that financial derivatives are not stores of value that are acquired to meet a balance of payments need and so do not meet the definition of reserve assets. Derivatives are used to manage existing assets, not acquired to help an economy meet a sudden, and unexpected, increase in the demand for foreign currency. Forward derivatives can move from positive to negative positions, while options can have zero or close to zero value. Clearly, in neither situation can it be said that these instruments are being acquired to be readily available to meet a balance of payments need. In addition, incorporating financial derivatives into reserves on the grounds of reserve management, that is by purpose of use, undermines the notion that instruments are classified in the balance of payments according to their nature and the characteristics of the functional category. However, only by specifying such use can the inclusion of both liability and asset positions in reserve assets be justified and the inclusion of derivatives that are used by monetary authorities for other purposes, such as debt management—which is of analytical interest in its own right—be avoided.

The views of Committee members are welcome on the proposed changes to the BPM5 rewrite. In particular, views are sought on:

(1) whether financial derivatives should be included in reserve assets and direct investment, and, if so, whether they should be included in reserve assets on a net basis;

(2) whether separate lines should be shown for financial derivatives in reserves and direct investment.

Preface

This document is the rewrite of the fifth edition of the *Balance of Payments Manual (BPM5)* on the treatment of financial derivatives.

In response to large-scale changes in the size and nature of financial derivatives markets in recent decades, the *System of National Accounts 1993 (1993 SNA)* and the *BPM5* provided new standards for the treatment of financial derivatives. After the *1993 SNA* and the *BPM5* were published, financial derivatives markets evolved, and there were requests from national statisticians for clarification and amplification of the text of these two documents.

This recognition led to the creation of the Informal Group on the Measurement of Financial Derivatives that, in conjunction with the IMF Committee on Balance of Payments Statistics (the Committee) and the Expert Group meeting on the IMF's draft *Manual on Monetary and Financial Statistics*, produced discussion papers that were widely distributed and commented upon in the international statistical community. This process confirmed the view that financial derivatives should be treated as financial assets and that transactions in them, in general, be reported as separate transactions, rather than as integral parts of the value of underlying transactions or financial assets to which they may be linked as hedges. The process led to two significant changes in previous statistical standards. First, a less restrictive view was taken as to which financial derivatives fall within the SNA asset boundary, allowing for the inclusion of more over-the-counter (or non-exchange-traded) instruments. Second, and related to the first point, interest rate swaps and forward rate agreements were recognized as financial assets, and net cash settlement payments in these contracts classified as financial transactions rather than as investment income flows. Also agreed was the creation of a new functional category, financial derivatives, in the balance of payments and a new instrument, financial derivatives, in the national accounts. These changes were adopted by the Committee and the Inter-Secretariat Working Group on National Accounts (ISWGNA) at their October 1997 meetings, following which the Fund Statistics Department released *The Statistical Treatment of Financial Derivatives* in November 1997.

The ISWGNA and the Committee asked the Fund's Statistics Department to rewrite the description and the recommended treatment of financial derivatives for the 1993 SNA and the *BPM5*, using *The Statistical Treatment of Financial Derivatives* as the base. These rewrites have been prepared in such a way that the wording is, in many instances, identical in the two publications to minimize differences of interpretation. The *BPM5* rewrite was considered by the October 1998 meeting of the Committee and adopted, subject to further review on whether to include financial derivatives in *direct investment* and *reserve assets*. The latter issue was resolved at the Committee's October 1999 meeting.

This document is divided into two main parts. The first part is a new chapter of the *BPM5* on the new functional category *financial derivatives*. It examines their underlying features and indicates how they should be treated. The second part sets out the modifications to the existing parts of the *BPM5* that are required to take amount of the clarifications and changes. Only affected paragraphs and tables are shown, and they are set out in the existing order of chapters. Additions are highlighted, while deletions are struck through.

It is a provisional document; because it is consistent with *Provisional Operational Guidelines on the Data Template on International Reserves and Foreign Currency Liquidity*, any changes to the treatment of financial derivatives in reserve assets that may emerge from country practice in implementing it (by early 2002) will be included in this document at that time.

The release of this document has been coordinated with that of the *1993 SNA* rewrite, which has a longer process of dissemination and adoption.

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New chapter in Fifth Edition of *Balance of Payments Manual* on financial derivatives

FINANCIAL DERIVATIVES

Concept and Coverage

FD 1. A financial derivatives contract is a financial instrument that is linked to a specific financial instrument or indicator or commodity, and through which specific financial risks (such as interest rate risk, currency, equity and commodity price risk, and credit risk, etc.) can be traded in their own right in financial markets. Transactions in financial derivatives should be treated as separate transactions rather than as integral parts of the value of underlying transactions to which they may be linked. The value of a financial derivative derives from the price of an underlying item, such as an asset or index. No principal amount is advanced which has to be repaid and no investment income accrues. Financial derivatives are used for a number of purposes including risk management, hedging, arbitrage between markets, and speculation.

FD 2. Financial derivatives enable parties to trade specific financial risks to other entities that are more willing, or better suited, to take or manage these risks, typically, but not always, without trading in a primary asset or commodity. The risk embodied in a derivatives contract can be traded either by trading the contract itself, such as with options, or by creating a new contract which embodies risk characteristics that match, in a countervailing manner, those of the existing contract owned. This latter is termed *offsetability*[2], and occurs in forward markets. Offsetability means that it will often be possible to eliminate the risk associated with the derivative by creating a new, but "reverse", contract that has characteristics that countervail the risk of the first derivative. Buying the new derivative is the functional equivalent of selling the first derivative, as the result is the elimination of risk. The ability to countervail the risk on the market is therefore considered the equivalent of tradability in demonstrating value. The outlay that would be required to replace the existing derivative contract represents its value -- actual offsetting is not required to demonstrate value.

[2] "Offsetability" should not be confused with an "offset" which is the legal right of a debtor to net its claims against the same counterparty. This *Manual* recommends that positions be recorded on a gross basis wherever possible.

FD 3. There are two broad types of financial derivatives. In a ***forward contract***, which is unconditional, two counterparties agree to exchange a specified quantity of an underlying item (real or financial) at an agreed-upon price (the *strike price*) on a specified date. In an ***option contract***, the purchaser acquires from the seller a right to buy (or sell, depending on whether the option is a call or a put) a specified underlying item at a strike price on or before a specified date. Unlike debt instruments, financial derivatives do not accrue investment income; nor are principal amounts advanced which are to be repaid.

FD 4. The value of the financial derivative derives from the price of the underlying item: the reference price. Because the future reference price is not known beforehand, the value of the financial derivative at maturity can only be anticipated, or estimated. The reference price may relate to a commodity, a financial instrument, an interest rate, an exchange rate, another derivative, a spread between two prices, or an index or basket of prices. An observable reference price for the underlying item is essential for calculating the value of any financial derivative — if there is no observable prevailing market price for the underlying item, it cannot be regarded as a financial asset. Transactions in financial derivatives should be treated as separate transactions, rather than as integral parts of the value of underlying transactions to which they may be linked. However, embedded derivatives (see para. FD6) should not be separately identified and valued from the primary instrument.

FD 5. Financial derivatives contracts are usually settled by net payments of cash. Exchange traded contracts, such as commodity futures, are often settled before maturity. Cash settlement is a logical consequence of the use of financial derivatives to trade risk independently of ownership of an underlying item. However, some financial derivative contracts, particularly those involving foreign currency, are settled by delivery of the underlying item.

FD 6. The following types of financial instruments are not financial derivatives for balance of payments purposes.

- A ***fixed price contract for goods and services*** is not a financial derivative, unless the contract is standardized so that the market risk therein can be traded in financial markets in its own right.

- ***Insurance*** is not a financial derivative. Insurance contracts provide individual institutional units exposed to certain risks with financial protection against the consequences of the occurrence of specified events, many of which cannot be expressed in terms of market prices. Insurance is a form of financial intermediation in which funds are collected from policyholders and invested in financial or other assets which are held as technical reserves to meet future claims arising from the occurrence of the events specified in the insurance policies: that is, insurance manages event risk primarily by the pooling, not the trading, of risk.

- ***Contingencies***, such as guarantees and letters of credit are not financial derivatives. The principal characteristic of a contingency is that one or more conditions must be fulfilled before a financial transaction takes place. Typically, these contingencies are not instruments that facilitate the trading of specific financial risks.

- An ***embedded derivative*** (a derivative feature that is inserted in a standard financial instrument and inseparable from the instrument) is not considered a financial derivative for balance of payments purposes. If a primary instrument such as a security or loan contains an embedded derivative, the instrument should be valued and classified according to its primary characteristics, such as a security or loan, even though the value of that security or loan may well be different from comparable securities and loans because of the embedded derivative. Examples are bonds that are convertible into shares and securities that carry the option of repaying the principal in a different currency from that of issuance.

FD 7. In addition, ***timing delays*** that arise in the normal course of business, and which may entail exposure to price movements, do not, for balance of payments purposes, give rise to transactions and positions in financial derivatives. Such timing delays include normal settlement periods for spot transactions in financial markets, and those that arise in the normal course of trade in goods and services.

FD 8. Financial derivatives that can be valued separately from the underlying items to which they are linked should be included in the ***financial account*** of the balance of payments and in the international investment position, regardless of whether they are "traded" on- or off-exchange.

Forwards

FD 9. Under a ***forward*** contract, the two counterparties agree to exchange a specified quantity of an underlying item (real or financial) at an agreed contract price -- strike price -- on a specified date. This class of financial derivative includes futures and swaps. ***Futures*** contracts are forward contracts traded on organized exchanges. Futures and other forward contracts are typically, but not always, settled by the payment of cash or the provision of some other financial instrument rather than the actual delivery of the underlying item. Futures are valued and traded separately from the underlying item. If the forward contract is a ***swap*** contract, the counterparties exchange cash flows based on the reference prices of the underlying items, in accordance with pre-arranged terms. Forward rate agreements and forward foreign exchange contracts are common types of forward contracts. Interest-rate and cross-currency interest-rate swaps are common types of swap contracts. (See paragraphs FD27 and FD28 for further discussion)

FD 10. At the inception of a forward contract, risk exposures of equal market value are exchanged. Both parties are potential debtors, but a debtor/creditor relationship can be established only after the contract goes into effect. Thus, at inception, the contract

normally has zero value. However, during the life of a forward contract, the market value of each party's risk exposure may differ from the zero market values at the inception of the contract as the price of the underlying item changes. When a price change in the underlying item occurs, an asset (creditor) position is created for one party and a liability (debtor) position for the other. The debtor/creditor relationship may change both in magnitude and direction over the life of the forward contract.

Options

FD 11. The purchaser of an ***option*** contract pays a premium to the writer of the option. In return, the buyer acquires the right but not the obligation to buy (call option) or sell (put option) a specified underlying item (real or financial) at an agreed contract price (the strike price) on or before a specified date. A major difference between forward and options contracts is that, whereas either party to a forward contract is a potential debtor, the buyer of an option acquires an asset, and the option writer incurs a liability. However, the option may expire worthless; the option will be exercised only if settling the contract is advantageous to the buyer. The buyer may make gains of unlimited size, and the option writer may experience losses of unlimited size.

FD 12. Options are written on a wide variety of underlying items such as equities, commodities, currencies, and interest rates (including caps, collars, and floors[3]). Options are also written on futures, swaps (known as swaptions), and other instruments such as caps (known as captions).

FD 13. On organized markets, option contracts are usually settled in cash, but some option-type contracts are normally settled by the purchase of the underlying asset. For instance, warrants are financial contracts that give the holder the right to buy, under specified terms, a certain number of the underlying asset, such as equity shares. If warrants are exercised the underlying asset is usually delivered. Warrants can be traded separately from the underlying assets to which they are linked.

Recording of Financial Derivative Transactions and Positions

FD 14. The statistical treatment of financial derivatives in the balance of payments and the international investment position involves the following steps:

- Recognizing that the exchange of claims and obligations at the inception of a derivative contract is a true financial transaction that creates asset and liability positions that normally have, at inception, a zero value in the case of forward instruments, and a value equal to the premium in the case of options;

[3] A cap places an upper limit, a floor a lower limit, and a collar upper and lower bounds on floating rate interest payments/receipts.

- Treating any changes in the value of derivatives as holding gains or losses;

- Recording transactions in secondary markets of marketable derivatives, such as options, as financial transactions;

- Recording any payments at settlement as transactions in financial derivative assets or liabilities, as appropriate (i.e., no income arises from settlement of financial derivatives[4]);

- Recording the outstanding value of financial derivatives at market price in the international investment position.

Valuation of positions

FD 15. A key characteristic of most derivatives contracts is that the counterparties commit themselves forward to an agreed price at which they will or are willing to transact in an underlying item. From this the net present value (or market price) of the financial derivative derives from the difference between the agreed contract price of the underlying item and the prevailing, or expected prevailing, market price, appropriately discounted, of that item. In contrast, for options (both on- and off-exchange), the price of options are the price itself as they are directly observable. This is because the purchaser of an option premium, unlike the parties to a forward, acquires an asset -- the right to buy or sell a specified underlying item -- and the price of that asset has to be established. The price of an option depends on the potential volatility of the price of the underlying instrument, the time to maturity, and interest rates, in addition to the difference between the strike price and the market price of the underlying item. In the specific case of a swap contract based on a notional principal amount, its value derives from the difference, appropriately discounted, between the expected gross receipts and gross payments.

FD 16. Financial derivatives are valued at their market price on the balance sheet recording date. Changes in prices between recording dates are classified as revaluation gains or losses. If market value data are unavailable, other fair value methods, such as options models or discounted present values, may be used to value derivatives.

Payments at inception

FD 17. The purchaser of an option pays a *premium* to the seller. The full price of the premium is recorded as the acquisition of a financial asset by the buyer and as the incurrence of a liability by the seller. In some instances, the premium may be paid after the

[4] Financial derivatives transactions may take place between two parties directly or through an intermediary. In the latter case, implicit or explicit service charges may be involved. However, it is usually not possible to distinguish the implicit service charge. This *Manual* recommends that net settlement payments under derivative contracts be recorded as financial transactions.

inception of the derivative contract. In this case, the value of the premium payment is recorded as an asset at the time the derivative is purchased, financed by a loan from the writer.

FD 18. The creation of a forward contract does not normally involve the recording of a transaction in financial derivatives as risk exposures of equal value are usually being exchanged, i.e., there is zero exposure and hence zero value for both sides.

FD 19. Commissions and fees paid at inception or during the life of the derivative to banks, brokers, and dealers, are classified as payments for services. These are payments rendered for services provided within the current period, and are independent of the asset and liability relationships that are created by the derivative.

Resale of derivatives in secondary markets

FD 20. Resales of derivatives in secondary markets, whether exchange-traded or over-the-counter, are valued at the market price and recorded in the ***financial account*** as transactions in financial derivatives.

Settlement payments

FD 21. *Net settlement payments* are financial transactions, similar to transactions at maturity of other financial instruments. At settlement, either a cash payment is made, or the underlying item is delivered.

- When a financial derivative is settled in cash, a transaction in the derivative is recorded equal to the cash value of the settlement. No transaction in the underlying item is recorded. In most instances, when a cash settlement payment is received, a reduction in financial derivative assets (a credit) will be recorded; similarly, when a cash settlement payment is made, a reduction of financial derivative liabilities (a debit) will be recorded. However, in some circumstances, this does not hold: when a contract, such as with an interest rate swap, involves on-going settlement, and a cash settlement is received, there will be an increase in financial derivative liabilities (a credit) if, at the time of the settlement payment, the contract is in a liability position. The reverse also applies, that is, when a contract involves on-going settlement, a cash payment will be recorded as an increase in an asset (a debit) if, at the time of the settlement, the contract is in an asset position. If, because of market practice, compilers are unable to implement this approach, it is recommended that all cash settlement receipts be recorded as reductions in financial assets, and all cash settlement payments be recorded as decreases in liabilities.

- When the underlying instrument is delivered, two transactions occur, and both are recorded. The transaction in the underlying item is recorded at its prevailing market price on the day of the transaction while the transaction in the derivative is recorded

as the difference between that same market price for the underlying item and the strike price in the derivative contract times the quantity.

- When more than one contract is settled in cash at the same time with the same counterparty, some of the contracts may be in an asset position and some in a liability position. In this situation, it is recommended that the transactions be recorded on a *gross basis*, that is, recording the transactions in assets separately from those in liabilities, thereby recording them as separate credit and debit flows. This treatment is preferred to that of recording the transactions on a *net basis*, that is, taking the sum of the liability flows from the sum of the asset flows and recording the resulting debit or credit as a single figure[5]. It is recognized, however, that, for practical purposes, they may be no alternative to net recording.

Margins

FD 22. Margins are payments of cash or collateral that cover actual or potential obligations under financial derivatives — especially futures or exchange-traded options. The provision of margin is a feature of financial derivative markets and reflects market concern over counterparty risk.

FD 23. ***Repayable margins*** consist of deposits or other collateral deposited to protect a counterparty against default risk. Ownership of the margin remains with the unit that placed the margin. Although its use may be restricted, a margin is classified as repayable if the depositor retains the risks and rewards of ownership, such as the receipt of income or exposure to holding gains and losses. At settlement, repayable margins — or the amounts of repayable margins in excess of any liability owed on the derivative — are returned to the depositor. In organized markets, repayable margin is sometimes known as *initial margin*.

FD 24. Repayable margin payments of cash are transactions in *deposits*, not transactions in financial derivatives. The depositor has a claim on the exchange, broker or other institution holding the deposit. Some countries may prefer to classify these "repayable margins"deposits within *other accounts receivable/payable* in order to reserve the term "deposits" for the monetary aggregates. When repayable margin deposits are made in non-cash assets (such as securities), no transactions are to be recorded. This is because no change in ownership has occurred so that the entity on whom the depositor has a claim — the issuer of the security — is unchanged.

FD 25. The payment of ***nonrepayable margin*** is a transaction in a derivative; it is paid to reduce a financial liability created under a derivative. Usually, in organized exchanges, nonrepayable margin (sometimes known as *variation margin*) is paid daily to meet

[5] However, the net basis is recommended for transactions in financial derivatives in *reserve assets*.

liabilities recorded as a consequence of daily marking derivatives to market value. The entity that pays nonrepayable margin no longer retains ownership of the margin or has the right to the risks and rewards of ownership, such as the receipt of income or exposure to holding gains and losses. A payment of nonrepayable margin is recorded as a reduction in financial derivative liabilities (a debit); the contra-entry is the reduction in a financial asset (a credit, probably currency and deposits); the receipt of nonrepayable margin is recorded as a reduction in financial derivative assets (a credit); the contra-entry is an increase in a financial asset (a debit, probably currency and deposits).

FD 26. Arrangements for margining can be complex, and procedures differ among countries. In some countries, repayable and nonrepayable margins are recorded in a single account and it may be difficult to distinguish between the two types. The actual institutional arrangements must be reviewed, including which unit makes payment and the instruments used. The key test is whether the margins are repayable or whether the payment of the margin represents an effective transfer of ownership between the counterparties to the financial derivative contract.

Treatment of Selected Financial Derivatives

Specific interest rate contracts

FD 27. An ***interest rate swap*** contract consists of a contract to exchange — in one currency over a specified period of time — cash flows related to interest payments or receipts on a notional amount of principal that is never exchanged. They are often settled through net cash payments by one counterparty to the other. A forward rate agreement (FRA) is a contract in which the counterparties agree on an interest rate to be paid, at a specified settlement date, on a notional amount of principal, that is never exchanged, of a specified maturity. FRAs are settled by net cash payments, that is, the difference between the rate agreed upon and the prevailing market rate at the time of settlement, is recorded as a transaction in the balance of payments. The buyer of the FRA receives payment from the seller if the prevailing rate exceeds the rate agreed upon; the seller receives payment from the buyer if the prevailing rate is lower than the rate agreed upon. The existence of active financial markets in these contracts results in holding gains and losses. The creation of interest rate swaps and FRA contracts normally requires no entries in the ***financial account*** as there is no exchange of value at inception. Net cash settlement payments for interest rate swaps and FRAs should be classified in the ***financial account*** as transactions in financial derivatives. Interest rate swaps usually involve on-going settlement during the life of the contract; FRAs are usually settled at maturity of the contract.

Specific foreign currency contracts

FD 28. A ***foreign exchange swap*** contract involves a spot sale/purchase of currencies and a simultaneous commitment to a forward purchase/sale of the same currencies. A ***forward foreign exchange*** contract involves a commitment to transact in specified

foreign currencies at an agreed exchange rate in a specified amount at some future agreed date. A ***cross-currency interest rate swap*** contract, sometimes known as a currency swap, involves an exchange of cash flows related to interest payments and, at the end of the contract, an exchange of principal amounts in specified currencies at an agreed exchange rate. There could also be an exchange of principal at the beginning of the contract. In that case, there may be subsequent repayments, which include both interest payments and the amortization of principal, made over time, according to pre-arranged terms. Streams of interest payments resulting from swap arrangements are to be recorded in the ***financial account*** as transactions in financial derivatives and repayments of principal are to be recorded under the relevant instrument.

FD 29. For foreign currency financial derivative contracts, it is necessary to distinguish between transactions in the financial derivatives contract and the requirement to deliver and receive underlying principal associated with the contract. As with other forward contracts, the creation of a foreign currency financial derivatives contract does not normally lead to the recording, in the ***financial account***, of a transaction under financial derivatives: any initial sale or purchase of currency is a transaction that will be recorded in the *other investment* category of the ***financial account***, at the exchange rate agreed by the counterparties. The exchange rate for the forward sale/purchase of currencies under a foreign currency derivative contract is agreed by the two counterparties at the time of the establishment of the contract. The derivative contract acquires value as the prevailing market exchange rate differs from the exchange rate agreed upon in the contract . At the time of settlement, the difference between the values of the currencies exchanged, measured in the unit of account and at the prevailing exchange rate, should be allocated to transactions in financial derivatives. In other words, if the value of the currency received exceeds that of the currency paid, a reduction in financial derivative assets (a credit) is recorded: the contra-debit entry is an increase in another asset item in the ***financial account***, probably *other investment: assets: currency and deposits*. When the value of the currency received is less than that of the currency paid, the opposite applies, i.e., a reduction in financial derivatives liabilities is recorded (a debit): the contra-credit entry is another item in the ***financial account***, probably a reduction in *other investment: assets: currency and deposits*

Credit Derivatives

FD 30. The financial derivatives described in the previous sections are related to ***market risk***, which relates to changes in the market prices of securities, commodities, interest and exchange rates. Financial derivatives that are used primarily to trade credit risk are known as ***credit derivatives*****.** They are designed for trading in loan and security default risk. Credit derivatives can be either forward-type or option-type contracts. Like other financial derivatives, credit derivative contracts are frequently drawn up under standard master legal agreements, and contain procedures for the provision of collateral and margining, which provide a means to make a market valuation.

FD 31. There are a number of common types of credit derivatives. ***Total return swaps*** involve the swapping of cash flows and capital gains and losses related to the liability of a lower-rated creditor for cash flows related to a guaranteed interest rate, such as an inter-bank rate, plus a margin. ***Spread options*** are contracts with values derived from the interest rate spread between higher quality credit and lower quality credit; for example, if the spread narrows sufficiently, the option holder benefits from exercising the option. ***Credit default swaps*** involve the swapping of the risk premium inherent in an interest rate on a bond or loan, usually on an on-going basis, in return for a cash payment, payable in the event of default by the debtor. Some credit default swap contracts require that one party make only a *single* payment to the other in order to be financially protected against the risk of a catastrophe befalling the creditor. For such contracts, reference prices may not be readily available, and the single premium contracts would be more properly classified as a form of insurance rather than a financial derivative.

Selected Supplementary Information

FD 32. As financial derivatives are risk transferring instruments, there may be interest from analytical and policy-making points of view in presenting transactions and positions in financial derivatives by type (option-type and forward-type) and by category of risk, such as foreign exchange, interest rate, and other risk.

II. Modifications to Existing Parts of *BPM5*

Chapter VIII: Classification and Standard Components of the Balance of Payments

176. The classification of standard components in the ***financial account*** is based on these criteria:

All components are classified according to type of investment or by functional breakdown (*direct investment, portfolio investment, financial derivatives, other investment, reserve assets*).

For the category of *direct investment*, there are directional distinctions (abroad or in the reporting economy) and, for the equity capital ~~and~~ other capital components and financial derivatives within this category, asset or liability distinctions.

For the categories of *portfolio investment, financial derivatives,* and *other investment* there are the customary asset/liability distinctions.

Particularly significant for *portfolio investment* and *other investment* is the distinction by type of instrument (equity or debt securities, trade credits, loans, currency and deposits, other assets or liabilities). In this Manual, traditional and new money market and other financial instruments ~~and derivatives~~ are included in portfolio investment.

For *portfolio investment, financial derivatives*, and *other investment* there are distinctions by sector of the domestic creditor for assets or by sector of the domestic debtor for liabilities. These distinctions serve to facilitate links with the income accounts, the international investment position, the SNA, and other statistical systems.

The traditional distinction, which is based on original contractual maturity of more than one year or one year or less, between long- and short-term assets and liabilities applies only to *other investment*. In recent years, the significance of this distinction has clearly diminished for many domestic and international transactions.
Consequently, the long- and short-term distinction is accorded less importance in the SNA and in this Manual than in previous editions. However, because the maturity factor remains important for specific purposes — analysis of external debt, for example — it is retained in the Manual for other investment.

177 *Direct investment* — reflecting the lasting interest of a resident entity in one economy (direct investor) in an entity resident in another economy (direct investment enterprise) — covers all transactions between direct investors and direct investment enterprises. That is, *direct investment* covers the initial transaction between the two and all subsequent

transactions between them and among affiliated enterprises, both incorporated and unincorporated. Direct investment transactions occurring abroad and in the reporting economy are subclassified into equity capital, reinvested earnings, ~~and~~ other capital (intercompany transactions) and financial derivatives. For equity capital, ~~and~~ other capital, and financial derivatives claims on and liabilities to affiliated enterprises and to direct investors are distinguished. Transactions between affiliated banks and between other affiliated financial intermediaries are limited to equity and permanent debt capital. (See paragraph 372.)

178. *Portfolio investment* covers transactions in equity securities and debt securities; the latter are ~~subsectored~~ subclassified into bonds and notes, and money market instruments~~, and financial derivatives (such as options) when the derivatives generate financial claims and liabilities~~. Various new financial instruments, other than financial derivatives, are covered under appropriate instrument classifications. (Transactions covered under *direct investment* and *reserve assets* are excluded.)

New paragraph to follow paragraph 178.

178a *Financial derivatives* covers financial instruments that are linked to other specific financial instruments, indicators or commodities, and through which specific financial risks (such as interest rate risk, currency, equity and commodity price risk, and credit risk, etc.) can be traded in their own right in financial markets. Transactions in financial derivatives should be treated as separate transactions rather than as integral parts of the value of underlying transactions to which they may be linked.

Chapter XIII: Other Services

258. Financial services cover financial intermediary and auxiliary services (except those of insurance enterprises and pension funds) conducted between residents and nonresidents. Included are intermediary service fees, such as those associated with letters of credit, bankers' acceptances, lines of credit, financial leasing, and foreign exchange transactions. (For the latter, the spread between the midpoint rate and the buying/selling rate is the service charge.) Also included are commissions and other fees related to transactions in securities -- brokerage, placements of issues, underwritings, and redemptions~~, and arrangements of swaps, options, and other hedging instruments~~; commissions and fees paid for the arrangement of financial derivatives contracts[6]; commissions of commodity futures traders; and services related to asset management, financial market operational and regulatory services, security custody services, etc. Service charges on purchases of International Monetary Fund resources are included

[6] Financial derivatives transactions may take place between two parties directly or through an intermediary. In the latter case, implicit or explicit service charges may be involved. However, it is usually not possible to distinguish the implicit service charge. This *Manual* recommends that net settlement payments under derivative contracts be recorded as financial transactions. However, where possible, the service charge component should be separately recorded.

among an economy's financial service payments, as are charges (similar to commitment fees) associated with undrawn balances under stand-by or extended arrangements with the IMF.

Chapter XIV: Income

274. *Investment income* (property income in the *SNA*) covers income ~~derived from a resident entity's ownership of foreign financial assets~~ earned on the provision of non-produced capital. Such provision is usually evidenced by the ownership of foreign financial assets. Financial derivative assets do not represent the provision of finance capital; their value derives from changes in the price of factors used to construct the derivative contract. Therefore, no investment income is earned on financial derivatives. The most common types of investment income are income on equity (dividends) and income on debt (interest). Dividends, including stock dividends, are the distribution of earnings allocated to shares and other forms of participation in the equity of incorporated private enterprises, cooperatives, and public corporations. Dividends represent income that is payable without a binding agreement between the creditor and the debtor. Among other types of income on equity are (i) earnings of branches and other unincorporated direct investment enterprises and (ii) direct investors' shares of earnings of incorporated direct investment enterprises. (The latter type of earnings, which are not formally distributed, are earnings other than dividends.) Shares of reinvested earnings attributed to direct investors are proportionate to the participation of the direct investors in the equity of the enterprise. Also, in principle, there is imputed income to households from net equity in life insurance reserves and in pension funds. This imputed income is included indistinguishably under *other investment*. Interest, including discounts in lieu of interest, comprises income on loans and debt securities (i.e., such financial claims as bank deposits, bills, bonds, notes, and trade advances). ~~Net interest flows arising from interest rate swaps also are included (See paragraph 406).~~ Interest is payable in accordance with a binding agreement between the creditor and the debtor.

280. Portfolio investment income comprises income transactions between residents and nonresidents and is derived from holdings of shares, bonds, notes, and money market instruments ~~and associated with financial derivatives~~. This category is subdivided into income on equity (dividends) and income on debt (interest). See Chapter XIX for details on new financial instruments ~~and treatment of financial derivatives, such as options~~ included in *portfolio investment*. The financial instrument classification scheme for portfolio investment income is consistent with that in the ***financial account*** and with that in the international investment position. Subsectoring into domestic institutional sectors (monetary authorities, general government, banks, and other) is included under *Selected Supplementary Information*. (See table following Chapter VIII.) A variety of other supplementary disaggregations by foreign sector, etc., may be desirable for specific analytical purposes.

Chapter XVI: Structure and Characteristics of the Capital and Financial Account

308 The standard components of both the ***current account*** and the ***capital and financial account*** are discussed in Chapter 8. Coverage of the ***capital and financial account*** is described in paragraphs 172 through 181, and the classification of components appears at the end of the chapter. ***Capital and financial account*** transactions presented in this *Manual* are the same as those reflected in the ***capital and financial accounts*** of the SNA external accumulation accounts. However, in the balance of payments, the primary basis for classification of the ***financial account*** is functional category (i.e., *direct investment*, *portfolio investment*, *financial derivatives*, *other investment*, and *reserve assets*) while the SNA classification is primarily by type of instrument: monetary gold, currency and deposits, loans, etc. (See Chapter 3 for details of the relationship between the two sets of accounts.) The structure of the ***capital and financial account*** also is generally compatible with other statistical systems of the IMF and is consistent with the classification of related income components of the **current account** and with the international investment position.

315. ~~However, options and other~~ Financial derivatives are included among financial items, ~~in accordance with the treatment of these items in the SNA. These instruments~~ which is consistent with their treatment in the SNA. There are active financial markets in these instruments, and they can be valued by reference to the market prices of the derivatives themselves or to the market prices of the ~~commitments~~ real or financial items underlying the derivatives. ~~Thus,~~ Both parties to a derivative contract recognize a financial instrument: one party recognizes a liability and the other recognizes a claim. Alternatively, this value could be viewed as the amount one party must pay to the other party in order to extinguish the contract. As a result, derivatives satisfy the definition (see paragraph 314) of foreign financial assets and liabilities. A full discussion of financial derivative instruments appears in ~~Chapter 19~~ the chapter on that subject.

318**.** To establish whether a transaction involving a foreign asset is a transaction between a resident and a nonresident, the compiler must know the identities of both parties. The information available on transferable claims constituting foreign assets may not, however, permit identification of the two parties to the transaction. That is, a compiler may not be able to ascertain whether a resident, who acquired or relinquished a transferable claim on a nonresident, conducted the transaction with another resident or with a nonresident, or whether a nonresident dealt with another nonresident or with a resident. Thus, a recommendation that the balance of payments be confined solely to asset transactions between residents and nonresidents would be difficult or impossible to implement. Also, the introduction, in this *Manual*, of a domestic sectoral breakdown for the *portfolio investment, financial derivatives* and *other investment* components of the ***financial account*** makes it necessary to record certain transactions between resident sectors within the economy—although such transactions cancel each other for the total economy. As a result, recorded transactions may include not only those that involve assets

and liabilities and take place between residents and nonresidents but also those that involve transferable assets of economies and take place between two residents and, to a lesser extent, transactions that take place between nonresidents. (See paragraph 334.)

324**.** Two or more changes in a specific asset, or changes in two or more different assets classified in the same standard component, are consolidated in a single entry. This entry reflects the net effect of all the increases and decreases that occur during the recording period in holdings of that type of asset. For example, purchases (by nonresidents) of securities issued by resident enterprises of an economy are consolidated with sales (by nonresidents) of such securities, and the net change is recorded for that item. Net decreases in claims or other assets and net increases in liabilities are recorded as credits; net increases in assets and net decreases in liabilities are recorded as debits. There is one exception to this recommendation: it is recommended that transactions in financial derivative instruments in *reserve assets* be recorded only as a single figure, that is, the change in liabilities be deducted from the change in assets. It is also recognized that, for practical purposes, this may be the only means by which transactions in financial derivatives in other functional categories (*direct investment* and *financial derivatives*) can be recorded.

330. ~~Four~~ Five broad categories of investment, each of which is dealt with in a subsequent chapter, are distinguished.

Direct investment

The direct investor seeks a significant voice in the management of an enterprise operating outside his or her resident economy. To achieve this position, the investor must almost invariably provide a certain, often substantial, amount of the equity capital of the enterprise. The direct investor may also decide to supply other capital to further enterprise operations. Because of the direct investor's special relationship to the enterprise, his motives in supplying capital will be somewhat different from those of other investors. Thus, the capital supplied by a direct investor will probably exhibit characteristic behavior. *Direct investment* is classified primarily on a directional basis—resident direct investment abroad and nonresident investment in the reporting economy—and is subdivided into equity capital, reinvested earnings, ~~and~~ other capital and financial derivaitves. Equity capital and other capital, in turn, are subdivided into asset and liability transactions. (Related income, however, is shown on a net basis in the **current account**.)

Portfolio investment

Cross-border investment in equity and debt securities (other than *direct investment*) is both quantitatively and analytically significant. Such cross-border investment therefore warrants separate recording and coverage, particularly in view of the trend towards free international movement of capital and the growth of new financial instruments and new

market participants. Coverage of this category is expanded to reflect these developments and to include money market debt instruments ~~and financial derivatives,~~ as well as longer-term debt and equity securities.

Financial Derivatives

Transactions in options and forwards, including swaps, have grown in importance in recent years, particularly activity outside organized exchange markets. Inclusion of financial derivatives as a separate functional category recognizes both this importance and the different nature of these instruments compared with other financial instruments. With financial derivatives, no capital is advanced to be repaid, nor does any interest accrue on financial derivatives. In previous printings of the fifth edition of this manual, financial derivatives data were included as a sub-category within portfolio investment. Compilers may continue with this approach if activity is too small to justify presenting data on financial derivative activity in a separate functional category, but should separately classify derivatives if amounts are significant.

Other investment

This residual group comprises many different kinds of investments. In practice, it is not feasible to draw any further functional distinctions among the various types because the reasons underlying the flows are too numerous and varied. Other breakdowns are therefore used to distinguish behavioral differences among components of this category (i.e., trade credits, loans, currency and deposits, use of Fund credit, loans from the Fund, etc.).

Reserve assets

These are foreign financial assets available to, and controlled by, the monetary authorities for financing or regulating payments imbalances or for other purposes. *Reserve assets* consist of monetary gold, SDRs, reserve position in the Fund, foreign exchange, and other claims. Changes in the holdings of reserves may reflect payments imbalances or responses to them, official exchange market intervention to influence the exchange rate, and/or other actions or influences.

331. The distinction between assets and liabilities is always of interest. Even for financial intermediaries, which in effect borrow and relend abroad the same funds, the terms of the borrowing and lending are usually different. Thus, the two offsetting flows may have different implications for the balance of payments.

332. For portfolio investment, the type of instrument is the primary classification (i.e., equity and debt securities). Debt securities are subdivided into bonds and notes and money market instruments~~, and financial derivatives~~. Although the sectoral subdivision for *portfolio investment* is secondary, there is no implication that, in certain instances, it

may not be of equal interest to the compiling economy. The same holds true for *financial derivatives* and *other investment*.

333. For assets, the institutional sector of the domestic (resident) creditor and, for liabilities, that of the domestic debtor often are factors that influence transactions in financial items. The sectoring also improves links with the IMF and other statistical systems, including the SNA. This *Manual* distinguishes four sectors—monetary authorities, general government, banks, and other sectors[7] — for ~~both~~ *portfolio investment, financial derivatives* and *other investment*.

339. In the categories of *direct investment*, *portfolio investment*, *financial derivatives* and *reserve assets*, long- and short-term investment are not formally distinguished. For *direct investment*, such a distinction is not made because it is essentially determined by arbitrary enterprise decisions and because of the fact that there is no meaningful analytic distinction between the two maturities for intercompany flows. For *portfolio investment, financial derivatives* and *reserve assets*, formal maturity is not likely to be a significant factor affecting the behavior of the components of the categories.

Chapter XVIII: Direct Investment

369 The components of direct investment capital transactions, which—as noted in paragraph 330—are recorded on a directional basis (i.e., resident direct investment abroad and nonresident direct investment in the recording economy), are equity capital, reinvested earnings, ~~and~~ other capital associated with various intercompany debt transactions, and financial derivatives. Equity capital comprises equity in branches, all shares in subsidiaries and associates (except nonparticipating, preferred shares that are treated as debt securities and included under *direct investment*-other capital—see paragraph 370), and other capital contributions. Reinvested earnings consist of the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by subsidiaries or associates and earnings of branches not remitted to the direct investor. If such earnings are not identified, all branch earnings are considered, by convention, to be distributed. Because undistributed (reinvested) earnings result in additions to direct investors' equity in subsidiaries and branches, these earnings are included as direct investment capital transactions in amounts equal to (and with opposite sign) the corresponding entries recorded under direct investment income. (See paragraphs 278, 288, and 321.)

[7] See Appendix 2

New paragraph to follow 370

370a D*irect investment*, financial derivatives covers financial derivatives between direct investors and direct investment enterprises unless the transactions are part of the usual banking transactions (as described in paragraph 372).

372 Intercompany transactions between affiliated banks (depository institutions) and affiliated financial intermediaries (e.g., security dealers) -- including SPEs with the sole purpose of serving as financial intermediaries -- recorded under direct investment capital transactions are limited to those transactions associated permanent debt (loan capital representing a permanent interest) and equity (share capital) investment or, in the case of branches, fixed assets. Deposits and other claims and liabilities, including financial derivatives, related to usual banking transactions of depository institutions and claims and liabilities of other financial intermediaries are classified, as appropriate, under *portfolio investment, financial derivatives* or *other investmen*t. The stock of foreign assets and liabilities of banks and other financial intermediaries (international investment position) should be treated in a parallel manner.

375 *Direct investment* is often referred to as an asset for the economy of the direct investor and as a liability for the economy in which the direct investment enterprise operates. Actually, investor and enterprise have claims on, or liabilities to, each other—although the investor could be expected to have net foreign claims and the enterprise to have net foreign liabilities. It is recommended in this *Manual* that direct transactions in equity capital, ~~and~~ other capital (intercompany debt) and financial derivatives be recorded for assets (claims) and liabilities. Thus, in addition to a net investment transaction for each of these components, separate entries are made for the change in claims of direct investors on, and the change in liabilities to, affiliated enterprises. These entries are made under *direct investment*-abroad and vice versa for *direct investment*-in reporting economy. For recording of *direct investment* in the international investment position, the same entries are made. See the table presenting the standard components of the international investment position at the end of Chapter 23. However, as noted in Chapter 23, the related direct investment income on equity and debt is shown on a net basis for each direction.

Chapter XIX : Portfolio Investment

385. Portfolio investment includes ~~, in addition to~~ equity securities and debt securities in the form of bonds and notes and money market instruments ~~and financial derivatives such as options~~. Excluded are any of the aforementioned instruments included in the categories of *direct investment* and *reserve assets*. The expanded coverage in transactions reflects changes in international financial markets in recent years and includes the introduction of many new financial instruments within the framework of continuous innovation.

387. The categories of financial instruments classified and defined in the *Manual* are generally consistent with those in the SNA. The major components of *portfolio investment*, which are classified under assets and liabilities, are equity securities and debt securities, both usually traded (or tradable) in organized and other financial markets. Debt securities are subdivided into bonds and notes and money market instruments~~, and financial derivatives, including varieties of new financial instruments~~.

389. Debt securities cover (i) bonds, debentures, notes, etc.; and (ii) money market or negotiable debt instruments~~; and (iii) financial derivatives or secondary instruments, such as options, that usually do not extend to actual delivery and are utilized for hedging of risks, investment, and trading purposes~~.

390. Bonds, debentures, notes, etc. usually give the holder the unconditional right to a fixed money income or contractually determined variable money income. (Payment of interest is not dependent upon the earnings of the debtor.) With the exception of perpetual bonds, bonds and debentures also provide the holder with the unconditional right to a fixed sum as a repayment of principal on a specified date or dates. Included are nonparticipating preferred stocks or shares, convertible bonds, and bonds with optional maturity dates, the latest of which is more than one year after issue. [8] This category also includes negotiable certificates of deposit with maturities of more than one year; dual currency bonds; zero coupon and other deep discounted bonds; floating rate bonds; indexed bonds; and asset-backed securities, such as collateralized mortgage obligations (CMOs) and participation certificates. (Mortgages are not classified as bonds but are included under loans.)

392. ~~Certain financial instruments give the holder the qualified right to receive an economic benefit in the form of cash, a primary financial instrument, etc. at some future date. These instruments are referred to as derivatives or secondary instruments in that they are linked to either specific financial instruments or indicators (foreign currencies, government bonds, share price indices, interest rates, etc.) or to particular commodities (gold, sugar, coffee, etc.) that may be purchased or sold at a future date. Derivatives also may be linked to a future exchange, according to a contractual arrangement, of one asset for another. The instrument, which is a contract, may be tradable and have a market value. When that is the case, the characteristics of the instrument as a contingent asset or liability (not to be recorded in the balance of payments or in SNA sectoral balance sheets) change and give rise to treatment of the instrument as an actual financial asset or liability in the financial account. Among derivative instruments are options (on currencies, interest rates, commodities, indices, etc.), traded financial futures, warrants, and arrangements such as currency and interest rate swaps.~~

[8] ~~The conversion (into equities) option may be considered a tradable derivative (i.e., an asset separate from the underlying security). See paragraph 392. Separation of the value of a transaction into the value of the bond and the value of the option may be effected by reference to transactions in similar bonds traded without options.~~

393. Transactions in derivatives are treated as separate (mainly financial) transactions rather than being included as integral parts of underlying transactions to which they may be linked as hedges. There are several reasons for this treatment, which is consistent with that in the SNA. The counter party to a derivative transaction will be a different transactor than the transactor for the underlying transaction being hedged. Also, the two parties to the derivative transaction may have different motives--hedging, dealing in the instrument involved, or acquiring the derivative as an investment. Even if both parties are hedging, the hedging may be associated with different financial or other assets. If derivative transactions were included as integral parts of underlying transactions, such treatment would lead to asymmetries of measurement in the balance of payments accounts. For example, the counter party to a derivative contract that hedges an underlying position with a resident may also be a resident. In such an instance, the inclusion of the derivative as part of the underlying transaction would result in the incorrect inclusion of transactions in the balance of payments.

395. The expanded coverage, which includes traditional and new money market and derivative instruments and innovative long-term securities, of *portfolio investment* raises issues concerning the recording of balance of payments entries associated with these instruments. Such issues are discussed, for selected instruments, in subsequent paragraphs.

398. Among money market and derivative instruments and arrangements, and the treatment of short-term notes issued under NIFs, options, warrants, swaps, traded financial futures, and forward rate agreements are noted subsequently.

401. Options are contracts that give the purchaser of the option the right, but not the obligation, to buy (a call option) or to sell (a put option) a particular financial instrument or commodity at a predetermined price (strike price) within a specific time span or on a specified date. Some leading types of options are those on foreign currencies, interest rates, equities, commodities, specified indexes, etc. The buyer of the option pays a premium (the option price) to the seller (writer or issuer) for the latter's commitment to sell or purchase the specified amount of the underlying instrument or commodity or to provide, on demand of the buyer, appropriate remuneration. By convention--in this Manual and in the SNA--that commitment is treated as a liability of the seller and represents the current cost to the seller of buying out his contingent liability.

402. Conceptually, the payment of the premium referred to previously includes two elements: the purchase price of a financial asset and a service charge. In practice, it often is not possible to identify the service element separately. If the latter can be distinguished, it should be entered under financial services. If not, it is recommended that the full premium be recorded in the balance of payments as the acquisition of a financial asset by the buyer and as an incurrence of a liability by the seller. Subsequent trading (sales) of options is recorded in the financial account, as is the exercise or purchase/sale of the underlying financial instrument. If an option actually proceeds to delivery, which is not the usual case, the acquisition or sale of the underlying asset (real or financial) should be

recorded at the prevailing market price in the appropriate balance of payments component. Offsetting the entry would be the actual amount payable or receivable; the difference between that amount and the prevailing market price is reflected in an entry that extinguishes the option contract. If an option contract is closed out prior to delivery, the actual amount payable or receivable is offset by the entry extinguishing the option contract. When initial margin payments and subsequent increases or decreases are payable by the parties to options, the payments should be recorded as both assets and liabilities in the financial account under other investment, currency and deposits in the ***financial account***. Payments into, and withdrawals from, these accounts sometimes may be reflected in transactions in the traded options to which the accounts relate and, if so, are recorded under option transactions in the ***financial account***.

403. Warrants (a particular form of option) are tradable instruments giving the holder the right to buy from the issuer of the warrant (usually a corporation) a certain number of shares or bonds under specified conditions for a designated period of time. Warrants can be traded apart from the underlying securities to which the warrants are linked and thus have a market value. The treatment of warrants is the same as that for other options, and the issuer of the warrant is considered, by convention, to have incurred a liability, which is the counterpart of the asset held by the buyer and reflects the current cost of buying out the issuer's contingent liability.

404. Another variety of tradable warrant (usually issued by investment intermediaries) is a currency warrant, the value of which is based on the amount of one currency required to purchase another currency at or before the expiration date of the warrant. Currency warrants and cross-currency warrants with payments denominated in third currencies should be treated in a similar manner to other warrants.

405. A swap is a contractual arrangement involving two parties who agree to exchange, over time and according to predetermined rules, streams of payment on the same amount of indebtedness. The two most prevalent varieties of swaps are interest rate swaps and currency swaps. An interest rate swap involves an exchange of interest payments of different character (e.g., fixed rate and floating rate, two different floating rates, fixed rate in one currency and floating rate in another, etc.). A currency swap involves an exchange of specified amounts denominated in two different currencies and subsequent repayments reflecting principal and/or interest. (Central bank currency swap arrangements that are usually undertaken for exchange rate policy purposes and that involve the temporary exchange of deposits as of a particular date and the reversal of the transaction at a future date are referred to in paragraph 434.)

406. Balance of payments entries for streams of interest payments associated with swap transactions are recorded, on a net basis, in the current account, and streams of principal repayments are recorded in the financial account. Although neither party to a swap arrangement is considered to be the provider of a service to the other, any payment to a third party involved in arranging the swap is recorded under financial services.

~~407. A futures contract is an agreement between two parties to exchange a real asset for a financial asset, or to exchange, on a specified date at a predetermined rate, two financial assets. Traded financial futures, including those for interest rates, currencies, commodities, equities, or other indices, are recorded in the financial account in a similar manner to options. Transactions associated with non-traded financial futures are likely to occur infrequently and are recorded under the other assets or other liabilities components of other investment.~~

~~408. A forward rate agreement (FRA) is an arrangement according to which two parties agree on an interest rate to be paid, on a specified settlement date, on a notional amount of principal that is never exchanged. At that time, the settlement payment (i.e., the difference between the rate agreed upon and the prevailing market rate at the time of settlement) is recorded as a transaction in the balance of payments. The buyer of the FRA receives payment from the seller if the prevailing rate exceeds the rate agreed upon; the seller receives payment from the buyer if the prevailing rate is lower than the rate agreed upon. These payments are recorded as interest income in the current account of the balance payments. Because there is only a notional (not an actual) underlying asset, there are no entries in the financial account.~~

Chapter XX: Other Investment

411. Other investment is a residual category that includes all financial transactions not covered in *direct investment, portfolio investment, financial derivatives*, or *reserve assets* (discussed in Chapter 21).

412. As is the case with *portfolio investment*, assets and liabilities for *other investment* are classified primarily on an instrument basis. The sectors of domestic creditor or debtor—the secondary basis for the classification—are monetary authorities, general government, banks, and other sectors. (For the definitions of sectors, see Appendix 2.) In contrast to *direct investment* and *portfolio investment and financial derivatives*, the maturity distinction (long- term and short-term) is a third-level basis of classification.

413. The instrument subclassification for other investment (as is that for *portfolio investment*) is closely linked to the SNA categories for financial assets. (See Chapter 3). While the relative importance of types of investment differs considerably among countries, the types reflect most of the financial instruments and channels utilized for the acquisition of assets and incurrence of liabilities -- other than for *direct investment*, *portfolio investment, financial derivatives* and *reserve assets*. The instrument classification comprises trade credits, loans (including the use of Fund credit and loans from the Fund), currency and deposits (both transferable and other), and other assets and liabilities (for example, miscellaneous accounts receivable and payable).

421. Deposits comprise both transferable and other deposits. Transferable deposits consist of deposits that are exchangeable on demand at par without restriction or penalty, freely transferable by check or giro order, and otherwise commonly used to make

payments. Deposits may be denominated in domestic or foreign currencies. Other deposits include all claims (other than transferable deposits) reflecting evidence of deposit, including repayable margins made under financial derivative contracts. Typical examples are non-transferable savings deposits, time deposits; and shares (evidence of deposit) which are legally (or practically) redeemable on demand or on short notice -- in savings and loan associations, credit unions, building societies, etc.

422. Other assets and liabilities cover any items other than loans and currency and deposits. For example, capital subscriptions to international nonmonetary organizations are classified under this category, as are miscellaneous accounts receivable and payable. In countries in which repayable margins made in connection with financial derivative contracts are not classified as deposits, the margin payments should be recorded as part of this sub-component.

423. As noted in paragraph 372, transactions, other than those associated with permanent debt and equity investment, of banks and other financial intermediaries, that are in a direct investment relationship are included in *portfolio investment*, *financial derivatives* or *other investment*. Thus, loans and deposits of such institutions are included, as described in paragraphs 415 and 421, under those components.

Chapter XXI: Reserve Assets

424 *Reserve assets*, the ~~fourth~~ fifth major functional category of the ***financial account***, is an important component of balance of payments statistics and an essential element in the analysis of an economy's external position. *Reserve assets* consist of those external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitude of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes. (See paragraphs 425 and 432.) The category of *reserve assets*, as defined in this *Manual*, comprises monetary gold, SDRs, reserve position in the Fund, foreign exchange assets (consisting of currency and deposits, ~~and~~ securities and financial derivatives), and other claims. (See paragraph 443.) Securities that do not satisfy the requirements of *reserve assets* are included in *direct investment* and *portfolio investment*.

New paragraph to follow paragraph 442

442a Transactions in financial derivative instruments with nonresidents (including, for instance, forwards, futures, swaps and options) should only be recorded in *reserve assets* if they pertain to the management of reserve assets, are integral to the valuation of such assets and are under the control of the monetary authorities. In addition, such derivative products must be highly liquid and be settled in foreign currency. Transactions in financial derivatives recorded in *reserve assets*, unlike all other items, should be recorded by deducting transactions in liability positions from transactions in asset positions even if this results in a negative net asset position.

Chapter XXIII: International Investment Position

464 Classification of the international investment position (and of changes to the IIP) has two dimensions. (See the table at the end of this chapter.) In the rows of the table, the primary distinction is between assets and liabilities; the difference between the two represents the net position. Fully consistent with the balance of payments ***financial account***, the first IIP subclassification is by function. Assets are divided into *direct investment*, *portfolio investment*, *financial derivatives*, *other investment*, and *reserve assets*; liabilities are divided the same way (except for *reserve assets*).

465. Within the functional categories and in concordance with the income components of the ***current account*** and the ***financial account*** in the balance of payments, *direct investment* is subdivided into equity capital plus reinvested earnings, ~~and~~ other capital (intercompany debt) and financial derivatives. Claims on, and liabilities to, affiliated enterprises are shown separately. *Portfolio investment* is classified primarily by instrument — equity securities and debt securities~~, and financial derivatives~~ — and secondarily by appropriate sectors. *Financial derivatives* are classified by sector. *Other investment* also is classified first by instrument and then by sector. Included are trade credits, loans, currency and deposits, and other assets and liabilities (such as capital subscriptions to international, nonmonetary organizations and miscellaneous accounts receivable and payable). *Reserve assets* are largely interchangeable from a functional standpoint. (See paragraphs 437 through 443.)

468. *Portfolio investment* (equity securities and debt securities~~, and financial derivatives~~) is valued at current market prices at the appropriate reference dates. For equities that are listed in organized markets or are readily tradable, the value of outstanding stocks should be based on actual prices. The value of equities that are not quoted on stock exchanges or otherwise traded regularly should be estimated by using the prices of quoted shares that are comparable as to past, current, and prospective earnings and dividends. Alternatively, the net asset values of enterprises to which the equities relate could be used to estimate market values if the balance sheets of the enterprises are available on a current value basis. For debt securities that are listed in organized markets or are readily tradable, the outstanding value of stocks also should be determined on the basis of current market prices. For debt securities that are not readily tradable, the net present value of the expected stream of future payments/receipts associated with the securities could be used to estimate market value. (The net present value of any future receipt is equal to the value of that receipt when discounted at an appropriate interest rate.)

469. *Financial derivatives* in the international investment position are valued at current market prices at the appropriate reference dates. It is recommended that gross asset and gross liability data be compiled by summing respectively the values of all individual contracts in an asset position and the values of all individual contracts in a liability

position[9]. If market value data are unavailable, other fair value methods to value derivatives, such as options models or discounted present values, may be used. ~~Principles for valuation of financial derivatives in the investment position are, in some respects, less definitive than for other portfolio investment instruments. There are ongoing efforts by national and international accounting bodies to define standards for the measurement and recording of derivatives. Thus, in the *Manual*, a thorough treatment of derivative valuation is not attempted--particularly in view of continued innovations in this area. Rather, brief valuation guidelines that are consistent with those in the SNA and applicable to a number of existing derivatives are presented subsequently.~~

470 ~~Traded options, warrants, and traded financial futures -- all of which are treated as financial assets -- are included in the position at market values on the appropriate accounting dates.~~ For an option, the market value recorded is either the current value of the option -- that is, the prevailing market price -- or the amount of the premium paid as a proxy. The counterpart liability is attributable, by convention, to the writer of the option and is valued at the current ~~value~~ cost of buying out the rights of the option holder. For a warrant, the counterpart liability of the issuer is the current ~~value~~ outlay required to buy out ~~of buying out~~ the exercise rights of the holder. ~~A contract for a currency swap~~ A forward is recorded at market value; when payments are effected, the value of the asset and associated liability is amortized and subsequently reflected in the position on the appropriate accounting date. The market value of a forward contract can switch from an asset position and a liability position (and vice versa) between accounting dates, depending on price movements in the underlying item(s) from which the forward derives its value. All price changes, including those that result in such switches, are treated as revaluations. Hence, in the absence of settlement payments, when such a switch in position occurs, the value of the gross asset (liability) position at the close of the previous accounting period is revalued to zero, and the gross liability (asset) position revalued from zero to the value at the end of the present accounting period.

New paragraph to follow paragraph 473

473a The net marked-to-market value of financial derivative instruments with nonresidents (including, for instance, forwards, futures, swaps and options) should only be recorded in *reserve assets* if they pertain to the management of reserve assets, are integral to the valuation of such assets and are under the control of the monetary authorities. In addition, such derivative products must be highly liquid and be settled in foreign currency. If positions in financial derivatives are recorded in *reserve assets*, unlike all other items, they should be recorded by deducting liability positions from asset positions even if this results in a negative net asset position.

[9] There is one exception to this recommendation, for *reserve assets*. See paragraph 473a

Appendices

I. Relationship of the Rest of the World Account to the Balance of Payments Accounts and the International Investment Position

511 Coverage of account V.III.2, the SNA ***financial account,*** is identical with that of the ***financial account*** of the ***capital and financial account*** in the balance of payments, although the level of detail is different. (See Table 4 at the end of this appendix.) In the SNA, financial assets are classified primarily by type of instrument. In the balance of payments, financial items are classified primarily by function—*direct investment, portfolio investment, financial derivatives, other investment* (including loans), and *reserve assets*. In addition to categories identifying types of financial instruments (insurance technical reserves being an exception), the balance of payments contains an abbreviated sector breakdown (monetary authorities, general government, banks, and other sectors) to provide links with other bodies of economic and financial statistics such as money and banking, government finance, international banking, and external debt. Furthermore, to conform with the *SNA*, the *Manual* states that entries in the ***financial account*** of the balance of payments are recorded, in principle, on a net basis (increases less decreases in assets or liabilities). However, gross recording is included as supplementary information (for example, in the case of drawings and repayments on long-term loans).

IV. Accounting for Exceptional Financing Transactions

512 As presented in this *Manual*, sectorization of the balance of payments *portfolio investment, financial derivatives,* and *other investment* accounts and related components of the international investment position strengthens the links between the international accounts, the SNA, and IMF statistical systems such as money and banking, government finance, and international banking. In addition, the sectorization enhances the analytic usefulness of the accounts.

V. Selected Issues in Balance of Payments Analysis

556 In addition to current transactions (i.e., those involving the exchange of goods, the provision of services, and the receipt and payment of income and transfers), the flow of financial transactions (i.e., those involving changes in financial claims on, and liabilities to, the rest of the world) must be analyzed. As noted in chapters 8 and 16, these transactions have two main components: (i) narrowly defined financial transactions in *direct investment*, *portfolio investment*, *financial derivatives*, and *other investment* (including trade credits, loans, and deposits) and (ii) transactions in *reserve assets*. There are direct linkages between these components of a country's international transactions. For example, imports of goods are often financed by nonresident suppliers so that an increase in imports will typically be matched by a financial inflow. At the expiration of the financing period, the payment to the nonresident supplier will involve either a drawdown of foreign assets (e.g., foreign deposits held by domestic banks) or the replacement of the liability to the nonresident supplier by another liability to nonresidents. There are also

close connections between many ***financial account*** transactions. For example, the proceeds from the sale of bonds in foreign capital markets (a financial inflow) may be invested temporarily in short-term assets abroad (a financial outflow).

Balance of Payments: Standard Components

	Credit	Debit

1. Current Account

A. Goods and services

a. Goods
1. General merchandise
2. Goods for processing
3. Repairs on goods
4. Goods procured in ports by carriers
5. Nonmonetary gold
5.1 Held as a store of value
5.2 Other

b. Services
1. Transportation
1.1 Sea transport
1.1.1 Passenger
1.1.2 Freight
1.1 .3 Other
1.2 Air transport
1.2.1 Passenger
1.2.2 Freight
1.2.3 Other
1.3 Other transport
1.3.1 Passenger
1.3.2 Freight
1.3.3 Other
2. Travel
2.1 Business
2.2 Personal*
3. Communications services
4. Construction services
5. Insurance services**
6. Financial services
7. Computer and information services
8. Royalties and license fees

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* See Supplementary Information table on page 50 for components.

** Memorandum items: 5.1 Gross premiums
: 5.2 Gross claims

Balance of Payments: Standard Components

Credit Debit

9. Other business services
   9.1 Merchanting and other trade-related services
   9.2 Operational leasing services
   9.3 Miscellaneous business, professional, and technical services*
10. Personal, cultural, and recreational services
   10.1 Audiovisual and related services
   10.2 Other personal, cultural, and recreational services
11. Government services, n.i.e.

B. Income

1. Compensation of employees
2. Investment income
   2.1 Direct investment
      2.1.1 Income on equity
         2.1.1.1 Dividends and distributed branch profits**
         2.1.1.2 Reinvested earnings and undistributed branch profits**
      2.1.2 Income on debt (interest)
   2.2 Portfolio investment
      2.2.1 Income on equity (dividends)
      2.2.2 Income on debt (interest)
         2.2.2.1 Bonds and notes
         2.2.2.2 Money market instruments ~~and financial derivatives~~
   2.3 Other investment

C. Current transfers

1. General government
2. Other sectors
   2.1 Workers' remittances
   2.2 Other transfers

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* See Supplementary Information table on page 50 for components.

** If distributed branch profits are not identified, all branch profits are considered to be distributed.

Balance of Payments: Standard Components

	Credit	Debit
2. Capital and Financial Account		
A. Capital account		
1. Capital transfers		
1.1 General government		
1.1.1 Debt forgiveness		
1.1.2 Other		
1.2 Other sectors		
1.2.1 Migrants' transfers		
1.2.2 Debt forgiveness		
1.2.3 Other		
2. Acquisition/disposal of non-produced, nonfinancial assets		
B. Financial account		
1. Direct investment		
1.1 Abroad		
1.1.1 Equity capital		
1.1.1.1 Claims on affiliated enterprises		
1.1.1.2 Liabilities to affiliated enterprises		
1.1.2 Reinvested earnings		
1.1.3 Other capital		
1.1.3.1 Claims on affiliated enterprises		
1.1.3.2 Liabilities to affiliated enterprises		
1.1.4 Financial derivatives		
1.1.4.1 Claims on affiliated enterprises		
1.1.4.2 Liabilities to affiliated enterprises		
1.2 In reporting economy		
1.2.1 Equity capital		
1.2.1.1 Claims on direct investors		
1.2.1.2 Liabilities to direct investors		
1.2.2 Reinvested earnings		
1.2.3 Other capital		
1.2.3.1 Claims on direct investors		
1.2.3.2 Liabilities to direct investors		
1.2.4 Financial derivatives		
1.2.4.1 Claims on affiliated enterprises		
1.2.4.2 Liabilities to affiliated enterprises		

Balance of Payments: Standard Components

	Credit	Debit
2. Portfolio investment		
2.1 Assets		
2.1.1 Equity securities		
2.1.1.1 Monetary authorities		
2.1.1.2 General government		
2.1.1.3 Banks		
2.1.1.4 Other sectors		
2.1.2 Debt securities		
2.1.2.1 Bonds and notes		
2.1.2.1.1 Monetary authorities		
2.1.2.1.2 General government		
2.1.2.1.3 Banks		
2.1.2.1.4 Other sectors		
2.1.2.2 Money market instruments		
2.1.2.2.1 Monetary authorities		
2.1.2.2.2 General government		
2.1.2.2.3 Banks		
2.1.2.2.4 Other sectors		
~~2.1.2.3 Financial derivatives~~		
~~2.1.2.3.1 Monetary authorities~~		
~~2.1.2.3.2 General Government~~		
~~2.1.2.3.3 Banks~~		
~~2.1.2.3.4 Other sectors~~		
2.2 Liabilities		
2.2.1 Equity securities		
2.2.1.1 Banks		
2.2.1.2 Other sectors		
2.2.2 Debt securities		
2.2.2.1 Bonds and notes		
2.2.2.1.1 Monetary authorities		
2.2.2.1.2 General government		
2.2.2.1.3 Banks		
2.2.2.1.4 Other sectors		
2.2.2.2 Money market instruments		
2.2.2.2.1 Monetary authorities		
2.2.2.2.2 General government		
2.2.2.2.3 Banks		
2.2.2.2.4 Other sectors		
~~2.2.2.3 Financial derivatives~~		
~~2.2.2.3.1 Banks~~		
~~2.2.2.3.2 Other sectors~~		

Balance of Payments: Standard Components

	Credit	Debit
3. Financial Derivatives		
3.1 Assets		
3.1.1 Monetary authorities		
3.1 2 General government		
3.1.3 Banks		
3.1.4 Other sectors		
3.2 Liabilities		
3.2.1 Monetary authorities		
3.2.2 General government		
3.2.3 Banks		
3.2.4 Other sectors		
4.3 Other investment		
4.3.1 Assets		
4.3.1.1 Trade credits		
4.3.1.1.1 General government		
4.3.1.1.1.1 Long-term		
4.3.1.1.1.2 Short-term		
4.3.1.1.2 Other sectors		
4.3.1.1.2.1 Long-term		
4.3.1.1.2.2 Short-term		
4.3.1.2 Loans		
4.3.1.2.1 Monetary authorities		
4.3.1.2.1.1 Long-term		
4.3.1.2.1.2 Short-term		
4.3.1.2.2 General government		
4.3.1.2.2.1 Long-term		
4.3.1.2.2.2 Short-term		
4.3.1.2.3 Banks		
4.31.2.3.1 Long-term		
4.3.1.2.3.2 Short -term		
4.3.1.2.4 Other sectors		
4.3.1.2.4.1 Long-term		
4 3.1.2.4.2 Short-term		
4 3.1.3 Currency and deposits		
4 3. 1.3.1 Monetary authorities		
4 3.1.3.2 General government		
4 3.1.3.3 Banks		
4 3.1.3.4 Other sectors		

Balance of Payments: Standard Components

	Credit	Debit
4 3.1.4 Other assets		
4 3.1.4.1 Monetary authorities		
4 3.1.4.1.1 Long-term		
4 3.1.4.1.2 Short-term		
4 3.1.4.2 General government		
4 3.1.4.2.1 Long-term		
4 3.1.4.2.2 Short-term		
4 3.1.4.3 Banks		
4 3.1.4.3.1 Long-term		
4 3.1.4.3.2 Short-term		
4 3.1.4.4 Other sectors		
4 3.1.4.4.1 Long-term		
4 3.1.4.4.2 Short-term		
4 3.2 Liabilities		
4 3.2.1 Trade credits		
4 3.2.1.1 General government		
4 3.2.1.1.1 Long-term		
4 3.2.1.1.2 Short-term		
4 3.2.1.2 Other sectors		
4 3.2.1.2.1 Long-term		
4 3.2.1.2.2 Short-term		
4 3.2.2 Loans		
4 3.2.2.1 Monetary authorities		
4 3.2.2.1.1 Use of Fund credit and loans from the Fund		
4 3.2.2.1.2 Other long-term		
4 3.2.2.1.3 Short-term		
4 3.2.2.2 General government		
4 3.2.2.2.1 Long-term		
4 3.2.2.2.2 Short-term		
4 3.2.2.3 Banks		
4 3.2.2.3.1 Long-term		
4 3.2.2.3.2 Short -term		
4 3.2.2.4 Other sectors		
4 3.2.2.4.1 Long-term		
4 3.2.2.4.2 Short-term		

Balance of Payments: Standard Components

	Credit	Debit

4 ~~3~~.2.3 Currency and deposits
4 ~~3~~.2.3.1 Monetary authorities
4 ~~3~~.2.3.2 Banks
4 ~~3~~.2.4 Other liabilities
4 ~~3~~.2.4.1 Monetary authorities
4 ~~3~~.2.4.1.1 Long-term
4 ~~3~~.2.4.1.2 Short-term
4 ~~3~~.2.4.2 General government
4 ~~3~~.2.4.2.1 Long-term
4 ~~3~~.2.4.2.2 Short-term
4 ~~3~~.2.4.3 Banks
4 ~~3~~.2.4.3.1 Long-term
4 ~~3~~.2.4.3.2 Short -term
4 ~~3~~.2.4.4 Other sectors
4 ~~3~~.2.4.4.1 Long-term
4 ~~3~~.2.4.4.2 Short-term
5.~~4~~. Reserve assets
5 ~~4~~.1 Monetary gold
5 ~~4~~.2 Special drawing rights
5 ~~4~~.3 Reserve position in the Fund
5 ~~4~~.4 Foreign exchange
5 ~~4~~.4.1 Currency and deposits
5 ~~4~~.4.1.1 With monetary authorities
5 ~~4~~.4.1.2 With banks
5 ~~4~~.4.2 Securities
5 ~~4~~.4.2.1 Equities
5 ~~4~~.4.2.2 Bonds and notes
5 ~~4~~.4.2.3 Money market instruments ~~and financial derivatives~~
5 ~~4~~.4.3 Financial derivatives
5 ~~4~~.5 Other claims

International Investment Position: Standard Components

	Position at Beginning Of Year	Changes in Position Reflecting: Trans-actions	Price Changes	Exchange Rate Changes	Other Adjust-ments	Position at End of Year
A. Assets						
1. Direct investment abroad[10]						
1.1 Equity capital and reinvested earnings						
1.1.1 Claims on affiliated enterprises						
1.1.2 Liabilities to affiliated enterprises						
1.2 Other capital						
1.2.1 Claims on affiliated enterprises						
1.2.2 Liabilities to affiliated enterprises						
1.3 Financial derivatives						
1.3.1 Claims on affiliated enterprises						
1.3.2 Liabilities to affiliated enterprises						
2. Portfolio investment						
2.1 Equity securities						
2.1.1 Monetary authorities						
2.1.2 General government						
2.1.3 Banks						
2.1.4 Other sectors						
2.2 Debt securities						
2.2.1 Bonds and notes						
2.2.1.1 Monetary authorities						
2.2.1.2 General government						
2.2.1.3 Banks						
2.2.1.4 Other sectors						
2.2.2 Money market instruments						
2.2.2.1 Monetary authorities						
2.2.2.2 General government						
2.2.2.3 Banks						
2.2.2.4 Other sectors						
~~2.2.3 Financial derivatives~~						
~~2.2.3.1 Monetary authorities~~						
~~2.2.3.2 General government~~						
~~2.2.3.3 Banks~~						
~~2.2.3.4 Other sectors~~						

[10] Because direct investment is classified primarily on a directional basis -- abroad under the heading **Assets** and in the reporting economy under the heading **Liabilities** -- claim/liability breakdowns are shown for the components of each, although these sub-items do not strictly conform to the overall headings of **Assets** and **Liabilities**

International Investment Position: Standard Components

	Position at Beginning Of Year	Changes in Position Reflecting: Trans-actions	Price Changes	Exchange Rate Changes	Other Adjust-ments	Position at End of Year
3. Financial Derivatives						
3.1. Monetary authorities						
3.2 General government						
3.3 Banks						
3.4 Other sectors						
4 ~~3~~. Other investment						
4 ~~3~~.1 Trade credits						
4 ~~3~~.1.1 General government						
4 ~~3~~.1.1.1 Long-term						
4 ~~3~~. 1.1.2 Short-term						
4 ~~3~~. 1.2 Other sectors						
4 ~~3~~. 1.2.1 Long-term						
4 ~~3~~. 1.2.2 Short-term						
4 ~~3~~. 2 Loans						
4 ~~3~~.2.1 Monetary authorities						
4 ~~3~~.2.1.1 Long-term						
4 ~~3~~.2.1.2 Short-term						
4 ~~3~~.2.2 General government						
4 ~~3~~. 2.2.1 Long-term						
4 ~~3~~. 2.2.2 Short-term						
4 ~~3~~. 2.3 Banks						
4 ~~3~~..2.3.1 Long-term						
4 ~~3~~. 2.3.2 Short -term						
4 ~~3~~..2.4 Other sectors						
4 ~~3~~. 2.4.1 Long-term						
4 ~~3~~. 2.4.2 Short-term						
4 ~~3~~. 3 Currency and deposits						
4 ~~3~~.3.1 Monetary authorities						
4 ~~3~~.3.2 General government						
4 ~~3~~.3.3 Banks						
4 ~~3~~.3.4 Other sectors						

International Investment Position: Standard Components

	Position at Beginning Of Year	Changes in Position Reflecting: Trans-actions	Price Changes	Exchange Rate Changes	Other Adjust-ments	Position at End of Year
4 ~~3~~. 4 Other assets						
4 ~~3~~. 4.1 Monetary authorities						
4 ~~3~~. 4.1.1 Long-term						
4 ~~3~~. 4.1.2 Short-term						
4 ~~3~~. 4.2 General government						
4 ~~3~~. 4.2.1 Long-term						
4 ~~3~~. 4.2.2 Short-term						
4 ~~3~~. 4.3 Banks						
4 ~~3~~.4.3.1 Long-term						
4 ~~3~~.4.3.2 Short-term						
4 ~~3~~.4.4 Other sectors						
4 ~~3~~.4.4.1 Long-term						
4 ~~3~~.4.4.2 Short-term						
~~4~~.5 *Reserve assets*						
~~4~~.5.1 Monetary gold						
~~4~~.5.2 Special drawing rights						
~~4~~.5.3 Reserve position in the Fund						
~~4~~.5.4 Foreign exchange						
~~4~~.5.4.1 Currency and deposits						
~~4~~.5.4.1.1 With monetary authorities						
~~4~~.5.4.1.2 With banks						
~~4~~.5.4.2 Securities						
~~4~~.5.4.2.1 Equities						
~~4~~.5.4.2.2 Bonds and notes						
~~4~~.5.4.2.3 Money market instruments ~~and financial derivatives~~						
~~4~~.5.4.3 Financial derivatives (net)						
~~4~~.5.5 Other claims						

International Investment Position: Standard Components

	Position at Beginning Of Year	Changes in Position Reflecting: Trans-actions	Price Changes	Exchange Rate Changes	Other Adjust-ments	Position at End of Year
B. Liabilities						
1. Direct investment in reporting economy[11]						
1.1 Equity capital and reinvested earnings						
1.1.1 Claims on direct investors						
1.1.2 Liabilities to direct investors						
1.2 Other capital						
1.2.1 Claims on direct investors						
1.2.2 Liabilities to direct investors						
1.3 Financial derivatives						
1.3.1 Claims on affiliated enterprises						
1.3.2 Liabilities to affiliated enterprises						
2. Portfolio investment						
2.1 Equity securities						
2.1.1 Banks						
2.1.1 Other sectors						
2.2 Debt securities						
2.2.1 Bonds and notes						
2.2.1.1 Monetary authorities						
2.2.1.2 General government						
2.2.1.3 Banks						
2.2.1.4 Other sectors						
2.2.2 Money market instruments						
2.2.2.1 Monetary authorities						
2.2.2.2 General government						
2.2.2.3 Banks						
2.2.2.4 Other sectors						
~~2.2.3 Financial derivatives~~						
~~2.2.3.1 Monetary authorities~~						
~~2.2.3.2 General government~~						
~~2.2.3.3 Banks~~						
~~2.2.3.4 Other sectors~~						

[11] Because direct investment is classified primarily on a directional basis -- abroad under the heading **Assets** and in the reporting economy under the heading **Liabilities** -- claim/liability breakdowns are shown for the components of each, although these sub-items do not strictly conform to the overall headings of **Assets** and **Liabilities**

International Investment Position: Standard Components

	Position at Beginning Of Year	Changes in Position Reflecting: Trans-actions	Exchange Price Changes	Rate Changes	Other Adjust-ments	Position at End of Year
3. Financial Derivatives						
3.1. Monetary authorities						
3.2 General government						
3.3 Banks						
3.4 Other sectors						
4. Other investment						
43.1 Trade credits						
43.1.1 General government						
43.1.1.1 Long-term						
43.1.1.2 Short-term						
43.1.2 Other sectors						
43.1.2.1 Long-term						
43.1.2.2 Short-term						
4 3.2 Loans						
4 3.2.1 Monetary authorities						
4 3.2.1.1 Use of Fund credit and loans from the Fund						
4 3.2.1.2 Other long-term						
4 3.2.1.3 Short-term						
4 3.2.2 General government						
4 3.2.2.1 Long-term						
4 3.2.2.2 Short-term						
4 3.2.3 Banks						
4 3.2.3.1 Long-term						
4 3.2.3.2 Short -term						
4 3.2.4 Other sectors						
4 3.2.4.1 Long-term						
4 3.2.4.2 Short-term						
4 3.3 Currency and deposits						
4 3.3.1 Monetary authorities						
4 3.3.2 Banks						
4 3.4 Other liabilities						
4 3.4.1 Monetary authorities						
4 3.4.1.1 Long-term						
4 3.4.1.2 Short-term						

International Investment Position: Standard Components

	Position at Beginning Of Year	Changes in Position Reflecting: Trans-actions	Price Changes	Exchange Rate Changes	Other Adjust-ments	Position at End of Year
4 3.4.2 General government						
4 3.4.2.1 Long-term						
4 3.4.2.2 Short-term						
4 3.4.3 Banks						
4 3.4.3.1 Long-term						
4 3.4.3.2 Short-term						
4 3.4.4 Other sectors						
4 3.4.4.1 Long-term						
4 3.4.4.2 Short-term						