Chapter 6. International Investment Position

A. Concept and Coverage

6.1 This chapter will explain the coverage of the international investment position (IIP), its relationship to transactions and other changes in financial assets/liabilities, and its relationship to national balance sheets. This discussion will be based on *1993 SNA* paras. 13.1-7, *BPM5* paras. 461-463, and *BPT* paras. 680-689.

6.2 The chapter will state that the international investment position is the balance sheet of the stock of external financial assets and liabilities. The financial items that comprise the position consist of monetary gold, SDRs, claims on nonresidents, and liabilities to nonresidents. Financial assets and liabilities will be cross-referenced to Chapter 5, Classifications.

6.3 The manual will define the assets boundary, as in the *1993 SNA*. It will note that guarantees, operating leases, other nonfinancial contractual obligations, and contingencies are excluded from the definition of financial assets/liabilities (see the instrument classification in Chapter 5 Classifications). For example, contractual agreements between a franchisor and a franchisee that a certain percentage of the franchisee's income will be paid to the franchisor are not included in the asset boundary. However, it will be noted that these kinds of off-balance sheet obligations can have a significant impact, and there is increasing interest on recording them in business accounting and for use in economic analysis. Accordingly, the manual will be encourage compilers to consider providing information on a supplementary basis where these obligations are identified as being economically significant. This would be an extension of *BPM5* but consistent with the direction in the *Reserves Template* and *Debt Guide*.

> *[Question: Does this proposal have the right balance between recognition of the issue and avoidance of specific standards?]*

6.4 A table showing the structure and components of the IIP with numerical examples will be presented. It will set out how changes in the IIP result from financial account transactions and other changes in financial assets and liabilities during a period. The table below shows only the main components, but the manual will provide a breakdown, along the lines of Table 5.3 in Chapter 5 Classifications. Full standard components will be presented in an appendix.

Table 6.1. Overview of International Investment Position (including link to financial and other changes accounts)

	Beginning of period IIP	Changes due to: Transactions (= financial account of the balance of payments)	Changes due to: Other (= other changes in financial assets and liabilities account)	**End of period IIP**
Assets:				
Direct investment				
Portfolio investment				
Financial derivatives and employee stock options				
Other investment				
Reserve assets				
Total assets				
of which:				
Equity finance				
Debt instruments				
Other instruments				
***Liabilities*:**				
Direct investment				
Portfolio investment				
Financial derivatives and employee stock options				
Other investment				
Total liabilities				
of which:				
Equity finance				
Debt instruments				
Other instruments				
Net IIP				

6.5 The full standard presentation will include additional instrument detail, as well as sector, maturity, and currency detail. Other presentations could use different foci, emphasizing different aspects of the IIP. The *Debt Guide*, for example, focuses on the role of institutional sectors. Other various approaches can be developed through satellite accounts. The following is an example based on the balance sheet in the *1993 SNA* (but is designed for sector perspective rather than time series analysis).

Table 6.2 Overview of International Investment Position (with resident institutional sector breakdown)

Assets						Liabilities				
Total economy	**Households and NPISHs**	**General government**	**Financial corporations**	**Nonfinancial corporations**		**Nonfinancial corporations**	**Financial corporations**	**General government**	**Households and NPISHs**	**Total economy**
					Direct investment					
					Portfolio investment					
					Financial derivatives and employee stock options					
					Other investment					
					Reserve assets					
					Total assets/liabilities					
					Net IIP					

6.6 The manual will emphasize that a consistent ordering and level of detail should be used for assets and liabilities in tabulations of each of positions, financial account transactions, and other changes in financial assets and liabilities so as to allow the relationships between them to be analyzed. Similarly, a consistent level of detail for income (and, holding gains, where appropriate) and positions assists in the estimation of rates of return. (The concept of rate of return will be explained.)

6.7 The section will note that the *Debt Guide*, *CPISG2*, and *Reserves Template* can be seen as satellites of the IIP with their own specialized datasets and manuals, that is, they are based on core components that come from the IIP, with additional elements, such as more detail, alternative valuations, and supplementary data on contingencies, guarantees, and other off-balance sheet items.

B. Scope and Characteristics

6.8 The usual order of priority for classification of components in international accounts statistics is according to:

(a) Assets/liabilities—defined in Chapter 3 Accounting Principles;
(b) Functional category—defined in Chapter 5 Classifications;
(c) Direction of investment (in the case of direct investment), that is, direct investment abroad/direct investment in the reporting economy—defined in Chapter 5 Classifications;
(d) Instrument—defined in Chapter 5 Classifications;
(e) Institutional sector of resident party—defined in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence;
(f) Maturity (in the case of debt instruments)—defined in Chapter 5 Classifications; and
(g) Currency (in the case of debt instruments)—defined in Chapter 5 Classifications.

6.9 It will be noted other presentations may be used. The level of dissection may vary according to circumstances.

6.10 As in Chapter 5 Classifications, Chapter 7 Financial Account, and Chapter 10 Primary Distribution of Income Account, it will be stated that the level of detail should be the same as related income flows and transactions.

6.11 Particular cases relating to classification and treatment will be discussed:

(a) Financial leases. It will be noted that a financial lease is treated as a loan. (Because financial leases affect services, income, financial transactions, and positions, the manual will include an appendix to deal with all these aspects.) (Financial leases are dealt with briefly in *BPM5* para. 417 and at more length in *1993 SNA* paras. 13.23–24.)

(b) Reverse transactions, such as repurchase agreements, sell- and buybacks, carries, gold swaps, securities lending. It will be noted that although these arrangements involve a change in legal title, the obligation to return the security means that the original owner retains the risks and benefits of ownership. The manual follows economic concepts, rather than legal form, for a repo—the original owner retaining the economic ownership and the repurchase arrangement effectively being a loan, with the security acting as collateral. This proposal will be modified if necessary in the light of continued international discussions. (As reverse transactions affect income, financial transactions, and positions, an appendix will deal with all these aspects.) (Repurchase agreements were mentioned in *BPM5* para. 418, but securities lending was not discussed. They are dealt with at length in BOPCOM-01/16.)

(c) Short positions. Short positions occur when a unit sells assets (usually securities) that it does not own, so that the assets of an equivalent nature must be acquired later to make delivery. (For example, this technique is used when an investor believes the price will drop.) The short position will be shown as a negative holding. (In aggregate global holdings, the negative values will offset the holdings recorded by the counterparty to the short position, so that the aggregate value of the security is not under- or overstated.) This issue was not mentioned in *BPM5*.

(d) Assets and liabilities of the central bank of a monetary union. *BPM5* para. 90 stated that such financial assets and liabilities should be prorated to the member states of the monetary union. This issue will be considered, including reference to currency in circulation, and the reserves held by national central banks that are members of the monetary union. The residence of central banks of monetary and currency unions is discussed in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence. The treatment of monetary unions will be discussed in an appendix.

[Question: What treatments should be adopted?]

(e) Shares and other equity. As in *BPM5* and the *1993 SNA*, there will be no split according to the historic transactions that gave rise to it—funds contributed by owners, reinvested earnings, accumulated holding gains, reserves, etc.

[Comment: The objective of the position statement is to show the current value, rather than the type of transactions or other flows that gave rise to the value, which are shown in other accounts.]

C. Timing

6.12 As it shows stocks, the IIP relates to a particular point of time, usually the end of a (fiscal or calendar) year or a quarter, in contrast to other aggregate data in the international accounts statistics, which are flows and relate to a whole period. It will be noted that this characteristic means that stocks are converted at exchange rates at a point in time, while other data should use the exchange at the time of the flow.

6.13 Overnight deposits (or sweep accounts) involve funds being swept back and forth overnight. They should be consistently measured either before or after they are swept. If they are measured after they are swept, the sweeps would be shown in financial flows and the IIP. As these deposits give rise to interest flows, it appears preferable to measure data after the sweeping so that positions and flows are consistent.

[Question: What treatment should be adopted for sweep accounts?]

6.14 It will be noted that different time zones mean that items may be recorded at slightly different times (such as the varying closes of business) and, therefore, values. While this means that assets and liabilities may not be recorded exactly consistently, the differences are considered to be small and, in any case, not solvable.

D. Valuation Principles

6.15 The general principle for valuation throughout the international accounts is the market value. It will be noted that market prices for some types of positions are not available, so that market price equivalent valuation should be used. Chapter 3 Accounting Principles will deal with the basic principles, while this chapter will focus on issues particular to financial assets and liabilities. The presentation will be set out as in the *MFSM* paras. 196–198, 202, and 219–224; and, mainly for debt instruments, the *Debt Guide* paras. 2.31–2.52. The subsequent detailed methods provide advice on how to implement that general principle in particular cases.

6.16 Specific guidelines will be given for the valuation of loans. They will be discussed along the lines of *MFSM* paras. 205–207 and the *Debt Guide* paras. 2.35–2.41, taking into account any developments in international accounting standards.

(a) The current valuation principle is nominal value (including accrued interest), as defined in *MFSM* para. 206, *BPM5* para. 471, and *Debt Guide* para. 2.32. *MFSM* and *BPM5* appear to be the same, although the former uses the term “book value.” “Nominal value” will be continued as the terminology in the new manual. The new manual will distinguish between nominal and face value, as in the *Debt Guide* para. 2.33, in contrast to *BPM5* para. 471.

(b) Another possible valuation principle is “fair value.” This principle will be defined, explaining that this basis takes into account default risk and, in the case of fixed-rate arrangements, changes in interest rates. Depending on developments in international accounting standards, fair value could be adopted as a valuation basis (i) in all cases; (ii) for creditors only; or (iii) as a supplementary or memorandum item.

- Fair value is a more realistic approximation of market value measure of financial position, especially when a debtor is insolvent. It avoids the anomalies noted below when a loan changes hands below the nominal value. Its use in business accounting is likely to increase, particularly if *IAS39* is adopted. Statistical principles should take into account developments in accounting practice.
- While symmetry of reporting between debtors and creditors is essential to a statistical system, it may not be followed in some accounting practices.

[Question: (i) Should either nominal value or fair value be adopted, and should the valuation not adopted be considered as a memorandum item? (ii) Or should a decision be postponed until developments in international accounting standards are clear?]

(c) If nominal value is adopted, the following issues will need to be dealt with:

i. Provisions for bad debts/expected loan losses/nonperforming loans. These terms will be explained. The nominal value does not take into account these factors; however, they are analytically interesting and important for showing financial position. Accordingly, bad debt provisions and/or expected loan losses should be recorded for the creditor as a memorandum item, as per *MFSM* para. 207. In addition, it will be recommended that metadata on the definitions used to identify impaired loans be provided, because these definitions may differ between economies and over time. Loans should be reduced or eliminated at the point of write-off or write-down, which will be defined. (This topic will be dealt with in Chapter 8 Other Changes in Financial Assets and Liabilities Account.)

ii. Traded loans. For loans that are traded, but not sufficiently to be reclassified as securities, the nominal value would differ from the transaction value. If the nominal value is used for positions, the difference between nominal and transaction values will be shown as a valuation change in the other changes financial assets and liabilities account. This issue will be discussed fully in Chapter 3 Accounting Principles with a cross-reference in this chapter. (In *BPM5* para. 471, in some cases of traded loans, the position of the debtor is recorded at nominal values and the creditor at transaction values.)

iii. The point of write-off or write-down. This could be specified as in *1993 SNA* para. 11.23 and *MFSM* para. 194.

(d) Deposits and accounts payable/receivable give rise to the same issues of nominal and fair values as loans. The valuation principles will take into account the decision on loan valuations.

6.17 Guidelines will be given for the valuation of equity where there is no recent, observable market price. Important cases include much of direct investment, shares that cease trading (due to suspension, default, bankruptcy), and private equity (unlisted companies, joint ventures, unincorporated enterprises). The general principles for use of a market price equivalent will be discussed in Chapter 3 Accounting Principles. Particular methods were not dealt with in *BPM5*, but they were covered in *BPT* paras. 716-720 and Kozlow (2002). It is proposed to mention briefly some of the options and to emphasize the misleading nature of historic cost values.

[Question: (i) How far should compilation issues be discussed in this section?
(ii) Should any particular method(s) be endorsed in order to encourage international standardization?]

6.18 Specific guidelines will be given for the valuation of other instruments for particular issues:

(a) Monetary gold and other reserve assets. These items will be valued at market prices (*BPM5* para. 473).

(b) SDRs, use of Fund credit, and reserve position in the Fund. These items should be valued as calculated by the IMF (*BPM5* para. 473 and *Reserves Template* paras. 136-7).

(c) Debt instruments generally. For all debt instruments, the value used for the IIP should include the accrual of interest, as at the reference date. In this connection, the manual will explain the notions of “clean” and “dirty” prices.

(d) Debt securities. While the market value will be adopted as the standard, compilation of the nominal value will be a supplementary item for issuers of the security, for its own analytical interest, and for the purposes of compiling external debt statistics (see the *Debt Guide* para. 2.42, where both nominal and market values are recommended).

(e) The treatment of deposits at banks in liquidation. This will be discussed in Chapter 3 Accounting Principles.

(f) Insurance and pension fund liabilities to their policyholders, claimants, and beneficiaries. These should be valued at market prices or the market price equivalent. The manual will discuss actuarial valuation of insurance and pension fund liabilities. Insurance policies should not be valued at their surrender value, contrary to *BPT* para. 721. It will be recognized that, in many economies, these activities have very little, if any, cross-border element. Depending on the outcome of current discussions, liabilities of unfunded pension schemes may also be recognized.

(g) Financial derivatives. Valuation of positions will be discussed as per paras. 469–470 and 473a of the *Financial Derivatives Supplement to the Fifth Edition of the Balance of Payments Manual* (2002).

(h) Employee stock options. Positions in employee stock options will be valued at market prices, or by using a suitable option pricing model.

Appendices:

Comparison with the *Debt Guide:*

- A concordance table will show components of IIP that are included in debt.

References

BPM5 ch 16 and 23

1993 SNA ch 13

GFSM ch 7

Banque de France, *Repo-type Transactions Issue: The French Experience Relating to Stocks*, BOPCOM-01/40

A. Bloem and C. Gorter, *The Treatment of Nonperforming Loans in Macroeconomic Statistics*, IMF Working Paper 01/209

Bank of Japan, *Classification and Valuation of Domestic Loans Sold to Non-residents at a Discount in the Balance of Payments Statistics and International Investment Position,* BOPCOM-00/15

IMF, *The Macroeconomic Statistical Treatment of Reverse Transactions,* BOPCOM-01/16

IMF, *Treatment of "Short" Positions,* BOPCOM-03/15

IMF, *Working Group on Repurchase Agreements and Securities Lending*, BOPCOM-01/17

R. Kozlow, *Valuing the Direct Investment Position in U.S. Economic Accounts,* BOPCOM-02/29

L. Laliberté, *Foreign Portfolio Investment in Canadian Bonds,* CBOPWP/97/01

A. Ridgeway, *Treatment of Allowances for Loans Losses and Non-Performing Loans,* BOPCOM-01/23

R. Tremblay, *Calculation of Position and Interest on Canadian Bonds Held by Non-Residents*, CBOPWP97/03

Changes from *BPM5*

(a) *Changes proposed*:

The priority of classifications will be standardized (para. 6.8).

Totals for equity, debt, and other instruments will be shown (Table 6.1).

For untraded equity, adoption of proxy methods when book values are inadequate will be encouraged and the limitations in the analytical usefulness of historic cost data will be emphasized (para. 6.17).

Introduction of the notions of “clean” and “dirty” prices (para. 6.18(c)).

(b) *Changes raised as an option*:

Consideration to be given by compilers to record significant off-balance sheet commitments (para. 6.3).

Financial assets and liabilities of central banks of monetary unions will be discussed (para. 6.11(d)).

The possible treatment of sweep accounts is discussed (para. 6.13).

Possibility of adopting fair value as a replacement or supplementary valuation basis. Possible supplementary data of impaired loans. Clarification of valuation of traded loans (para. 6.16).

Possible methods of valuing untraded equity to market-equivalent values could be discussed and/or endorsed (para. 6.17).

Glossary

Book value
Buy-sell spread
Clean price
Dirty price
Face value
Fair value
Impaired loans
Nominal value
Nonperforming loans (relationship to impaired loans/bad debts/bad debt provisions/expected loan losses)
Overnight deposits
Rate of return
Repo

Reverse transaction (include sell and buy backs, carries, gold swaps)
Securities lending
Short positions
Sweep accounts