Chapter 7. Financial Account

A. Concept and Coverage

7.1 The financial account will be defined, and its structure and purpose outlined along the lines of *BPM5* paras. 313–342, *BPT* paras. 446–447, and the *1993 SNA* Chapter XI. It shows transactions in monetary gold, SDRs, residents' claims on nonresidents, and nonresidents' claims on residents. Then, the section will show the relationship of the financial account and its balancing item, to other elements of the international accounts.

7.2 Transactions in financial assets and liabilities will be discussed (with cross-references to Chapter 5 Classifications, to give examples of financial assets/liabilities, and Chapter 6 International Investment Position, to show the stocks of financial assets and liabilities).

7.3 The functions of the financial account will be presented from different perspectives:

(a) In its own right, it shows transactions in financial assets and liabilities, grouped by functional category and thence by instrument.

(b) In the context of the international investment position, it identifies which changes during the period arise from transactions, as distinct from valuation effects, reclassifications, etc., as in *BPM5* paras. 310 and 436. The identity for the closing balance sheet being equal to the opening balance sheet, plus changes due to transactions and other flows, will be stated.

(c) In the context of the international transaction accounts, it shows how the net balance of transactions in the capital and current accounts is financed.

(d) In conjunction with the national accounts, it shows total national borrowing/lending, the instruments and functional categories employed, and the contribution of the domestic institutional sectors.

7.4 Financial account entries will be explained as being counterpart entries to goods, services, income, transfers, capital, or other financial entries.

7.5 This chapter will state that financial transactions can be classified in a number of ways—functional categories, instruments, currency, maturity (definitions for which will appear in Chapter 5 Classifications). It will be noted that the relevant positions—see Chapter 6 International Investment Position—and income—see Chapter 10 Primary Income—should be classified in the same way so as to facilitate comparisons.

7.6 A table showing the structure and components of the financial account with a numerical example will be presented. The financial account will have the same structure as the international investment position—the only difference being the inclusion of "reinvestment of earnings" under "direct investment abroad" and "direct investment in the reporting economy" in the financial account. Table 7.1 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 7.1. Overview of the Financial Account

	Net change
Net lending/borrowing	
Net changes in assets arising from transactions	
Direct investment	
Portfolio investment	
Financial derivatives and employee stock options	
Other investment	
Reserve assets	
Total changes in financial assets resulting from transactions	
Of which:	
Equity finance	
Debt instruments	
Other instruments	
Net changes in liabilities arising from transactions	
Direct Investment	
Portfolio investment	
Financial derivatives and employee stock options	
Other investment	
Total changes in financial liabilities resulting from transactions	
Of which:	
Equity finance	
Debt instruments	
Other instruments	

7.7 The manual will also note that there are many possible presentations as to signs, netting, ordering, and balancing items. A two-column presentation of this table could also be made, that is, one column for each of net changes in assets and net changes in liabilities. The two-column presentation has the benefit of facilitating comparisons of the changes in assets with the corresponding changes in liabilities category. However, the two-column presentation is not suitable for use for time-series data, and the one-column presentation aligns with the presentation of the opening and closing international investment positions reconciled with financial account transactions and other changes in assets and liabilities given in Chapter 6 International Investment Position.

7.8 Another alternative is a matrix presentation, as shown below, that allows compilers or analysts to clearly identify the sectoral dimensions of international financial transactions but that is not suitable for time series analysis. (This format is not being proposed as a standard presentation; the objective is to show that the underlying information can be presented in different ways to emphasize different aspects.)

Table 7.2 Overview of the Financial Account—Institutional Sector Presentation

Net changes in assets						Net changes in 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 changes in assets/liabilities					
					Net lending/borrowing					

B. Scope and Characteristics

1. General

7.9 Financial transactions are classified according to the following hierarchy of dimensions:

(a) Assets/liabilities—defined in Chapter 3 Accounting Rules;
(b) Functional category—defined in Chapter 5 Classifications;
(c) Direction of investment (in the case of direct investment), i.e., 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 Sector, 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.

7.10 In *BPM5*, the classification of transactions differs in order and level of detail from the classifications for incomes and positions. Standardization of transactions, other flows, positions, and income for each functional category will be recommended in order to facilitate analysis of the interrelationships.

7.11 The netting of values in the financial account will be explained. As explained in Chapter 3 Accounting Principles, netting in the financial account means offsetting increases in one type of asset with reductions in the same type of asset, and offsetting increases in one type of liability with reductions in the same type of liability. The reasons for net recording in the financial account, but not other accounts, will be explained. The potential usefulness of gross values in understanding financial markets will be considered, but they will not be introduced as standard components. (See *BPM5* paras. 324–327.)

2. Particular issues

7.12 Examples of some more complex transactions with financial account entries will be given, for example, loan repayment; accrual of interest; payment of previously accrued interest; payments at inception, completion, and during a financial derivative contract.

7.13 Special cases will be discussed:

(a) Reinvestment of earnings for direct investment, reinvestment of income attributed to life insurance and pension policyholders. In these cases, the financial account entry and counterpart income entry are both imputed. (See *BPM5* para. 321.) However, it will be noted that the values can be observed; it is the transaction that is imputed.

[Question: The term "reinvestment of earnings" is proposed for the financial account entry, to distinguish it from the equal and opposite income item. Is this change suitable?]

(b) Conversion of a convertible bond, rollover of a debt instrument, one party assuming obligations of another, and other changes in contractual terms. In these cases, this chapter will explain that two transactions are recognized—the original instrument is regarded as being canceled and a new one issued. (See *BPM5* para. 322.)

(c) Buy-sell spreads on financial instruments. The value of some transactions may need to be partitioned into a financial transaction and a financial service. The financial service component is the buy-sell spread or margin of traders. It is limited to dealers' "trading book" to exclude holding gains or losses. *BPM5* recognizes that there is a service margin for foreign exchange (para. 258) but not for other financial instruments (para. 323). This issue also concerns Chapter 9 Goods and Services and the *1993 SNA* production boundary and has recently been taken up by the OECD Task Force on Financial Services. The manual will follow the proposals adopted by the ISWGNA.

(d) Assets/liabilities of individuals changing residence ("migrants' transfers" of financial assets and liabilities). Under *BPM5* para. 354, there is an imputed transaction to cover the change in status of the financial assets, financial liabilities, and real estate of the individuals involved. As discussed in Chapter 3 Accounting Principles, it is proposed to remove this imputation from the financial account and treat these changes in the residence of the owner as reclassifications, to be included in the Other Changes in Financial Assets and Liabilities Account.

(e) Debt forgiveness. An entry is shown in the financial account, with a contra-entry in the capital account. Debt forgiveness (a mutually agreed outcome) will be contrasted with debt write-offs (a unilateral decision), which appear in the Other Changes in Financial Assets and Liabilities Account. (See *BPM5* para. 532 and relevant part of Chapter 12 Capital Account.)

(f) Allocation of SDRs and monetization/demonetization of gold. It will be noted that these are not financial transactions. (They should be shown in the Other Changes in Financial Assets and Liabilities Account.) (See *BPM5* para. 436.)

(g) Depository receipts and similar instruments. These instruments will be mentioned. That is, as having the residence and other characteristics of the underlying security, rather than according to their legal form as independent securities, which is an issue in determining whether a transaction in the depository receipt is cross-border. (Note: Issue of whether the existing treatment should be continued was raised in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence.) (See *CPISG2* paras. 3.80–3.85.)

(h) Strips. The manual will discuss strips and how they are to be treated: as the issue of a new instrument, following *Debt Guide* paras. 2.77–2.80 and *CPISG2* paras. 3.86–3.93.

(i) Financial or finite risk reinsurance. As little or no risk is transferred under financial reinsurance, it is in economic essence a financial transaction, rather than insurance. Regulatory practice usually means that financial reinsurance is already identified as being a financial transaction rather than insurance.

(j) Resident-to-resident transactions of a claim on a nonresident, for example, if a foreign bond is sold by one resident to another. This case was treated as an exception to the definition of balance of payments in *BPM5*; however, it is included in the more comprehensive definition of international accounts proposed in Chapter 1 Introduction, which is expressed in terms of resident-to-nonresident transactions and positions. (See *BPM5* footnote 1 to para. 13, and para. 318.) Despite being resident-to-resident transactions, these are included in the balance of payments because they involve a cross-border asset. If the transactors are residents of different sectors, it is necessary to record the transaction to report correctly the holdings of each sector and to reconcile opening and closing balance sheet positions. In practice, many of the transactions occur within a single sector, so they cancel out. The same principles apply for nonresident-to-nonresident transactions in claims on a resident. Because of data collection difficulties and the fact that these transactions cancel out for the economy as a whole, it will be recognized that correct reporting of these transactions may be a low priority in most cases.

(k) Counterparts to other imputed transactions. Since an imputed entry occurs for goods sent for processing, a counterpart financial account entry should be imputed, if possible. (If migrants’ transfers are maintained in capital transfers, then imputed financial account entries are needed for the financial assets and real estate of the individuals.)

(l) Interest accrued. The manual will note that accrued interest will be added to the relevant instrument, rather than as an account receivable/payable. This is consistent with the valuation of positions. (This issue will be cross-referenced to the discussion in Chapter 3 Accounting Principles).

(m) Reverse transactions. This section will note the issue of reverse transactions, with a cross-reference to the appendix that will present the transactions and related positions. (Reverse transactions were also mentioned in the context of positions data in Chapter 6 International Investment Position.)

(n) Real estate ownership by nonresidents. As noted in Chapter 4 Economic Territory, Units, Institutional Sector, and Residence, a notional resident unit is imputed for real estate purchase, so these transactions will be regarded as direct investment, rather than acquisition of land.

(o) Gold transactions. Transactions in gold between monetary authorities are included. If nonmonetary gold is not treated as a financial asset, as discussed in Chapter 5 Classifications, there will be a clarification of how monetization of gold will be recorded. Without recognition of nonmonetary gold as a financial asset, the acquisition of gold by a monetary authority would be treated as a goods transaction, followed by a reclassification shown in the other change in financial assets and liabilities account.

(p) The debtor/creditor and transactor principles for financial transactions. These are discussed under Chapter 4 Economic Territory, Units, Institutional Sector, and Residence under partner data.

[Question: Are there any other cases that should be mentioned?]

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References

BPM5, paras. 313–342, *Financial Derivatives Supplement*

BPT Chapter VIII

External Debt Statistics: Guide for Compilers and Users, paras. 253-254

International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template

CPISG2 paras. 3.60–3.79

1993 SNA Chapter XI

MFSM paras. 429–433, 448–465

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

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

Changes from *BPM5*

Changes proposed:

The word "capital" in financial account entries will be replaced by "finance" (Table 7.1).

The presentation, signs, netting, and ordering in the financial account will be consistent with IIP and income (para. 7.5).

Change of terminology for financial account entry to "reinvestment of earnings" (para. 7.13(a)).

Glossary

Captive insurer
Debt finance
Debtor/creditor principle
Equity finance
Financial lease
Financial reinsurance.
Gold swaps
Monetary gold
Monetization of gold/demonetization
Other finance
Reinvestment of earnings
Repos
Securities lending
SDRs
Strips