DRAFT

Monetary and Financial Statistics:

Compilation Guide

Chapter 4. Classification of Financial Assets

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Introduction

4.1 Classification of financial assets is covered in the *MFSM*, Chapter IV. The corresponding chapter in this guide provides a more detailed description of the characteristics of major categories of financial assets—particularly, those financial assets that contain major subcategories that need further description, or for which the asset classification may not always be readily apparent. The recommendations in this chapter are useful for distinguishing, in unobvious cases, between (1) deposits and loans, (2) loans and securities other than shares, and (3) loans and trade credit.

Deposits

Deposits include all claims on the central bank, other depository corporations, government units, and, in some cases, other institutional units that are represented by evidence of deposit. The category of deposits comprises transferable deposits and other deposits. ***MFSM*, ¶127.**

Loans and deposits, which may have almost identical characteristics, are distinguished on the basis of the representation in the documents that evidence them. ***MFSM*, footnote 8, p. 29.**

General principles

4.2 All financial instruments that can be used for direct third-party payments should be classified as transferable deposits, regardless of the designation of the instrument—i.e., checking account, current account, giro account, nostro/vostro account,[1] etc. Classification as a loan is precluded, because loans are not usable for third-party transfers. Differentiating between an other deposit (i.e., non-transferable deposit) and a loan can be more difficult. *This guide recommends that classification as an other deposit or as a loan be based on the instrument characteristics specified in the documentation and the national practice for distinguishing between other deposits and loans. Regardless of the classification, the financial instrument should have the same classification in the accounts of the creditor (holder of the financial asset) and the debtor (issuer of the liability).* Guidance for distinguishing between deposits and loans is provided in Annex 4.1. The guidance is based on contract terms and conditions that differ for deposits and loans. When funds are provided between financial corporations, the same classification—as an other deposit or a loan—should be used by both financial corporations.

Deposit overdrafts

[1] *Nostro account* (i.e., "our" account) is terminology for a domestic corporation's deposit account in a foreign bank; the same account is a *vostro account* (i.e., "your" account) from the perspective of the foreign bank that has the deposit liability. Nostro accounts usually are denominated in the national currency of the deposit-taking bank. *Loro account* is another name for *vostro account*.

4.3 Depositors in some countries are authorized to obtain credit in the form of an *overdraft*—a check or other item in an amount that overdraws a transferable deposit account. All outstanding claims arising from overdrawn deposit accounts should be classified as loans, rather than as negative balances in depositors' accounts, regardless of whether the depositor intentionally created the overdraft or inadvertently had insufficient funds in the account.

Cashier's checks

4.4 Depository corporations' customers purchase *cashier's checks* or similar instruments to use in paying suppliers of goods or services or in settling financial obligations. A cashier's check is a check drawn on the own account of a depository corporation. It is signed by the depository corporation's cashier and is made payable to the party specified by the purchaser of the check. *Whether purchased with currency or through deposit withdrawal, a cashier's check should be included within transferable deposit liabilities of the depository corporation on which it is written. For deposit classification by sector, the bank check should be attributed to the economic sector of the purchaser of the check, rather than to the economic sector of the recipient of the check*. If purchased by a customer in a money holding sector (see *MFSM*, ¶316-320), the cashier's check should be included in *transferable deposits included in broad money*. If purchased by central government, a nonresident, or (conceivably) another depository corporation, the cashier's check should be included in *transferable deposits excluded from broad money*.

4.5 Less commonly, a depository corporation's customer may purchase a *bank draft* (sometimes called a *teller's check*) that is a check or similar instrument written by a depository corporation against funds in its deposit account at another depository corporation. For a bank draft purchased by one of its customers, a depository corporation should record (1) a reduction in deposits liabilities, arising from a withdrawal from the customer's deposit holdings (or an increase in the depository corporation's currency holdings, if the check was purchased with cash) and (2) a reduction in its deposit holdings at the depository corporation on which the draft was written.[2] While the bank draft is being held by the purchaser of the draft or is in transit to the payee, it is not included in broad money.

[2] The depository corporation should record a reduction in its deposit holdings at the other depository corporation, even though the corresponding entry will not be made in the other depository corporation's accounts until the item has been presented for payment through the clearing system.

Margin deposits

Margins are payments of cash or deposits of collateral that cover actual or potential obligations incurred through financial derivatives—especially futures or exchange-traded options. ***MFSM*, ¶269.**

Repayable margin payments of cash are transactions in *deposits*, not transactions in financial derivatives. A depositor has a claim on an exchange, brokerage, or other institution holding the deposit. Some countries may prefer to classify repayable margin deposits within *other accounts receivable/payable* in order to reserve the term *deposits* for monetary aggregates. When a repayable margin deposit is made in a noncash asset (such as securities), no transaction is recorded, because no change in ownership has occurred. ***MFSM*, ¶271.**

4.6 *Repayable, or redeemable, margin deposits placed with depository corporations to meet the collateral requirements for repurchase agreements, financial derivatives, or other types of financial transactions should be classified as deposits, regardless of whether these deposits are included in broad money. Repayable margin deposits placed with other financial intermediaries also should invariably be classified as deposits.*

4.7 Repayable margin deposits placed in financial auxiliaries are a special case. Depending on national practice, the margin deposits liabilities of financial auxiliaries—brokers, dealers, clearinghouses for futures contracts, etc.—can be classified as *deposits* or as *other accounts payable – other*.[3] For consistency of record keeping, margin account holders should be informed as to whether their accounts are classified as *deposits* or *other accounts payable – other*.

Unallocated gold (and other precious metal) deposits

Gold loans may be undertaken to obtain an income return on gold. The gold that is placed on loan may be either monetary or nonmonetary gold. The gold remains on the books of the gold lender, and the lender retains the exposure to the market risk arising from movements in the market price of gold. Gold loans are not backed by cash collateral and, in some cases, are not backed by non-cash collateral. However, the gold may be on-sold by the borrower. This manual recommends that gold loans be treated as off-balance-sheet items (i.e., not recorded as transactions). If the gold is on-sold, however, the on-selling party (i.e., the gold borrower) should record a gold transaction, in like manner to gold swaps. **The gold underlying a gold loan is referred to as *gold in an allocated account* for which an ownership claim on physical gold exists. *Gold in an unallocated account*, which refers to a gold-denominated claim against a third-party (not the physical gold holder), is classified as a financial asset, specifically as a *deposit*. *MFSM*, ¶156; revised with bolded text added.**

4.8 The distinction between allocated and unallocated gold accounts is based on the nature of the account holders' claims. An *allocated gold account* is equivalent to a custody record of title to gold, whereas an *unallocated gold account* is an unsecured claim against a

[3] Trading on the futures exchanges results in a proliferation of margin accounts. Buyers and sellers of futures contracts are required to maintain margin deposit accounts with their brokers. Brokers that are members of the futures exchanges are required to maintain margin deposit accounts at the exchange clearinghouses. Non-member brokers hold margin deposits at member brokers that transact with the futures clearinghouses on their behalf. Clearinghouse placements of excess funds with depository corporations are regular deposit accounts, because no margin requirements are involved.

third party who is obligated to deliver a specified quantity of gold of a defined purity (or make a cash settlement).[4] A transaction in unallocated gold balances cannot be classified as a transaction in gold, because no change in title to physical gold has occurred.

4.9 *In the methodology of this guide, an unallocated gold account is classified as a foreign currency deposit*.[5] In many countries, unallocated gold accounts will represent claims only on nonresidents and therefore will be classified under *Other deposits – In foreign currency – nonresidents*.[6]

The same principle applies to an unallocated account for another precious metal (e.g., silver or platinum). *In the methodology of this guide, unallocated accounts for all precious metals are included in foreign currency deposits, and allocated accounts for all metals are included in nonfinancial assets.*[7]

IMF securities (central bank only)

4.10 Deposit liabilities of central banks include the IMF No. 1 and No. 2 accounts, which are transferable deposits that the IMF holds in central banks of member countries. Securities that have been substituted for No. 1 account liabilities also should be classified as deposits, because these liabilities have the characteristics of demand deposits rather than securities and, in particular, are encashable on demand by the IMF.

Reclassification of impaired deposits

This manual recommends exclusion of all deposit liabilities of nonoperating depository corporations from the monetary aggregates. These deposits should continue to be classified as restricted deposits as long as the nonoperating units continue to exist as legal entities. Reorganization, sale, or merger of the affected depository corporations may result in all or part of the deposits eventually becoming available to depositors. ***MFSM*, ¶308**.

[Note: In accordance with the recommendations below, financial corporations' holdings of deposits in nonoperating depository corporations should be reclassified as impaired loans.]

[4] Trading in allocated and unallocated gold takes place in an organized market (in particular, among members of the London Bullion Market Association, a representative body for gold and silver trading) and over the counter. Bullion market turnover is dominated by transfers of financial claims against metal account providers, rather than through transfers of title to allocated gold.

[5] Other depository corporations in a few countries offer deposit accounts for which the interest return is linked to the market price of gold, but without linkage to physical gold. These deposits are also classified as *Deposits – In foreign currency*.

[6] However, any gold-denominated deposit account with a third-party-payment feature would be classified under *Transferable deposits – In foreign currency*.

[7] Conceivably, deposit accounts could arise for financial claims on unallocated commodities other than precious metals.

4.11 *This guide recommends that financial corporations' holdings of impaired deposits—those that are expected to be partially or totally uncollectible—should be reclassified as loans.* In most respects, ''non-performing deposits" (i.e., uncollectible deposits) are indistinguishable from "non-performing loans"; impaired deposits have the same characteristics as impaired loans that are not secured by collateral. After reclassification, the loan (formerly, deposit) can be treated indistinguishably from other impaired loans. The expected loss on the loan (formerly, a deposit) is included in provisions for loan losses and in the data for expected loan losses.[8] The reclassification eliminates the need for separate treatment of "non-performing deposits," "provisions for deposit losses," and "expected deposit losses."

4.12 The reclassification applies to all impaired deposits—both transferable and other (i.e., non-transferable)— that are held by financial corporations, irrespective of resident/nonresident status of the nonoperating institution that is liable for the deposits. The financial corporation (or the receivership for the nonoperating institution) should be informed that, because of impairment, its deposit liabilities have been reclassified as loans. This information should be provided by the financial corporation that is the deposit holder.

4.13 Special consideration is given to other financial corporations' holdings of impaired deposits in a nonoperating depository corporation. All deposits liabilities of nonoperating depository corporations may be excluded from the national definition of broad money. If so, other financial corporations' impaired deposits in the closed depository corporation can be reclassified as loans without further consideration for compilation of broad money. However, deposit impairment may be recognized before the other depository corporation has closed, or national practice may be to include impaired deposits in broad money, after closure but before liquidation or reorganization of the depository corporation. In such circumstances, other financial corporation's deposit claims on the depository corporation still should be reclassified as a loan, and this loan (formerly, deposit) should be recognized as a special component of the broad money holdings of the other financial corporations.

Securities other than shares

Securities other than shares are negotiable instruments serving as evidence that units have obligations to settle by means of providing cash, a financial instrument, or some other item of economic value. ***MFSM*****, ¶134**

General principles

[8] The accounting for non-performing loans and provisions for loan losses and the compilation or the data for expected loan losses are covered in Chapter 5.

4.14 In the *MFSM* (and *1993 SNA*) terminology, a financial asset is *negotiable* if it is actively or inactively traded in a secondary market. To qualify as *negotiable*,[9] securities other than shares must be designed for prospective trading on an organized exchange or in the over-the-counter market, but demonstration of actual trading is not required. Many securities, though negotiable, are held to maturity by the original creditor. Some standard types of securities other than shares are shown in Table 4.1. Examples of securities issued and traded in international markets are described in Table 4.2.

Table 4.1. Securities other than shares: Some standard types

Short-term securities sold on a zero coupon (discount) basis

- Treasury bills and other securities issued by a central government or its agencies
- Tax anticipation notes and other securities issued by state and local governments
- Commercial and financial paper issued by nonfinancial and financial corporations
- Negotiable certificates of deposit issued by other depository corporations
- Bankers' acceptances

Long-term securities sold on a fixed-rate coupon basis

- Central government bonds
- General obligation and revenue bonds issued by state governments and municipalities
- Corporate bonds
- Negotiable certificates of deposit issued by other depository corporations
- Preferred stock (if qualifying as debt rather than equity)

Pass throughs and other asset-backed securities (including principal-only and coupon-only strips)

Securities with embedded derivatives

- Denominated in a foreign currency[1]
- Variable interest rate (including with interest caps, floors, or collars)[1]
- Interest and/or principal indexed to equity values, commodity prices, or other reference variables
- Callable at the option of the issuer
- Puttable at the option of the holder
- Convertible to equity shares
- Extendable maturity
- Credit derivative features

[1] Included under the broadest characterization of embedded derivatives.

4.15 For the monetary and financial statistics, financial corporations' asset holdings in the form of securities other than shares do not need to be disaggregated into short- and long-term categories, or into instrument categories such as those shown in Tables 4.1 and 4.2. Financial corporations' liabilities in the form of securities other than shares need to be disaggregated—

[9] A *negotiable instrument* is sometimes legally defined as an unconditional promise or order to pay a fixed amount of money. An ordinary check written on a deposit account would qualify as a negotiable instrument in the legal context, but not in the *MFSM* and 1*993 SNA* context.

by maturity and/or by instrument category—only to the extent necessary to distinguish between those securities included in broad money (if any) and those excluded from broad money. However, disaggregation by maturity or instrument type of the securities other than shares provide useful supplementary data, as indicated in the *MFSM* (¶391) and *1993 SNA* (¶11.58).

Table 4.2. Securities other than shares: Some types traded in international markets[1]

Short-term securities. Eurocurrency instruments, denominated in U.S. dollar, euro, yen, etc.

- *London certificates of deposit*. Negotiable certificates of deposit issued by a London bank or a London branch of a foreign bank.
- *Euro commercial paper* and *euronotes*
- *Euro bankers' acceptances*

Long-term securities. Foreign bonds are those issued outside the domestic market of the borrower.

- *Global bonds*. Simultaneously placed in the Euro and domestic markets.
- *Eurobonds*. Issued by a borrower in a foreign country, denominated in a Eurocurrency (U.S. dollar, euro, yen, etc.), and underwritten and sold by an international syndicate of financial corporations
- *Brady bonds*. Issued to refinance a developing country's debt to foreign commercial banks.
- *Floating-rate notes* (*FRNs*). Medium- to long-term securities with variable rates usually linked to the London interbank rate (offer, bid, or average rate).

[1] For descriptions of these and other instruments, see the *Coordinated Portfolio Investment Survey Guide*, Second edition (IMF, 2002), Appendices V and VI.

Securities (and other debt instruments) with embedded derivatives

An embedded derivative (a derivative feature that is inserted in a standard financial instrument and is inseparable from the instrument) is not considered a financial derivative for monetary and financial statistics purposes. If a primary instrument such as a security or loan contains an embedded derivative, the instrument is valued and classified according to its primary characteristics—even though the value of that security or loan may differ from the values of comparable securities and loans because of the embedded derivative. ***MFSM*, ¶254.**

4.16 In IAS 39, embedded derivatives are divided into (1) those that *are* closely related to the host instrument and (2) those that *are not* closely related (see IAS 39.AG33 and 39.AG30). *The recommendation in this guide is that an embedded derivative be treated as inseparable from the underlying, or host, instrument, irrespective of whether the embedded derivative is closely related or not closely related to the host contract.* [10] *The only exception applies to options that are of a detachable type that can be sold apart from the host instrument.* In this guide, warrants and other detachable options are classified as *non-embedded*, or stand-alone, derivative instruments, which corresponds to the treatment in IAS 39.10.

[10] The recommendations in this section also apply to loans, deposits, and equity shares that have embedded derivatives.

4.17 IAS 39.11 states that "An embedded derivatives shall be separated from the host contract and accounted for as a derivative under this Standard if, and only if: (a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract . . . ; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and (c) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss (i.e., a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss is not separated)." "Accounted for as a derivative" refers to separation of an embedded derivative for measurement (valuation) purposes, but does not specifying the financial asset classification for the embedded derivative. In particular, IAS 39.11 categorically states that "This Standard does not address whether an embedded derivative shall be presented separately on the face of the financial statements."

4.18 *This guide recommends that embedded derivatives classified separately or included within the category of financial derivatives, in accordance with national financial reporting standards, should be recombined with the host instrument in the accounts of the monetary and financial statistics.* The total value of the hybrid (combined) instrument is defined as the sum of host instrument value and the embedded derivative value, if separate values have been estimated for the host instrument and embedded derivative.

Pass-through and other asset-backed securities

4.19 *Asset-backed securities* are created through the *securitization* of various categories of loans, or through *double securitization*—the packaging and selling of securities that already are backed by other securities. *Pass-through securities* that are backed by fixed-rate mortgage loans are a prominent type of asset-backed securities. A financial corporation that originates residential mortgage loans may pool some of these assets and sell units, or portions, of the mortgage loan pool to investors. The units acquired by the investors are the mortgage-backed securities. The interest and principal payments made by the mortgagees within the pool are directly passed through to the investors who hold the mortgage-backed securities.[11]

4.20 A major source of uncertainty about the future cash flows from mortgage-backed securities arises from prepayment of residential mortgage loans in the pool. Homeowners may have the right to prepay the entire amounts of their mortgage loans without incurring prepayment penalties. Absence of prepayment penalties provides incentives for homeowners to refinance their homes when interest rates on new mortgage loans are below the interest rates on their existing mortgage loans. Other prepayments arise from relocation, when

[11] A more recent development has been the securitization of other type of loans—adjustable-rate mortgage loans, credit card receivables (certificates of amortized revolving debt), car loans (collateralized automobile receivables, or CARs), commercial and industrial loans, etc. In addition, corporate bonds (including junk bonds, which have relatively high default risk) have been securitized.

mortgagees sell their homes, liquidate their existing mortgage loans,[12] and acquire new homes and new mortgages. The prepayments have significant implications for mortgage lending and mortgage pass-through securities, given the risk that increases in prepayments will decrease the prevalence of interest payments and will accelerate the repayment of principal within the mortgage loan pool. From an accounting perspective, prepayments complicate the valuation of mortgage-backed securities, as described in Chapter 5.

4.21 *Collateralized mortgage obligations (CMOs)* are securities that are designed to attract investors who have differing sensitivities to prepayment risk,[13] depending on their individual portfolio management objectives for acquiring mortgage pass-through securities. A CMO can be backed by (1) direct securitization of a mortgage loan portfolio or (2) double securitization—backing in the form of a new or outstanding issue of mortgage pass-through securities. The distinguishing feature is that the securities issued as a CMO are divided into classes—for example, Class-A, Class-B, and Class-C—which provide progressively less protection against prepayment risk. All prepayment from the CMO mortgage loan pool are channeled to the Class-C securities until those in Class C are fully repaid. Subsequent repayments are passed through to the Class-B securities investors. Prepayments are passed through to the Class-A securities holders only after all Class-B securities have been retired. The bonds pay a guaranteed or fixed coupon rates that vary across classes. The Class-A coupon rate is less than the Class-B rate, which is less than Class-C rate—thereby rewarding Class-C securities holders for the highest risk of prepayments and, to a lesser extent, rewarding the Class-B securities holders for assuming prepayment risk that is greater than for Class-A securities.[14]

4.22 Financial corporations sometimes purchase bonds or similar instruments, *strip* the coupon payments, and sells the future cash flows to separate investors—i.e., the *principal only (PO)* claim sold to one investor and *coupon only (CO)* claims sold to one or more other investors. The principal and periodic coupon payments for the original bonds have been transformed into a series of zero-coupon bonds, with maturities matching the redemption date for the principal and coupon payment dates for the original bonds. The PO- and CO-strip investors receive the cash flows from the bonds on a pass-through basis. The financial corporation records liabilities (classified under securities other than shares and subclassified

[12] The life of a mortgage loan can be extended, if it is *assumable*—i.e., if the new homeowner is entitled to become the new mortgagee under the home seller's existing mortgage loan contract.

[13] A CMO is distinguished from a *collateralized debt obligation (CDO).* Both CMOs and CDOs are designed with tranches for investors with different sensitivities to risk. For a CMO, prepayment risk is the relevant risk; for a CDO, it is credit risk. The investors in each CDO tranche contracts for a portion of the credit risk, which is allotted to CDO tranches in the same manner that prepayment risk is allocated to CMO classes.

[14] CMOs sometimes have Z or R Classes. For Z-Class bondholders, all cash flows—coupon and principal payments plus accrued interest—are received as lump sums after all other classes are retired. Investors in R-Class (i.e., residual-class) CMOs receive whatever principal and reinvestment income remains in a CMO trust, after all other classes have been retired.

by economic sector of holder) for the cash flows that the financial corporation stripped and sold. Alternatively, the strips can be created at the initiative of the securities issuer. Financial corporations are purchasers, as well as creators, of PO and CO strips.

4.23 PO and interest-only (IO) strips are also created through securitization of mortgage-loan pools in a special form of a CMO. The IO-strip investors receive cash flows from the periodic interest payments received from the mortgage loan pool, and the PO-strip investors receive the principal portions of the periodic payments. The cash flows and yields for the PO and CO strips, like those for other pass-through securities backed by mortgage loans, are influenced by loan prepayments.

4.24 A *mortgage-backed bond (MBB)* is an asset-backed instrument that differs from pass-through securities and CMOs with respect both to the treatment of cash flows and to the institutional arrangements. MBBs are backed by mortgage loans that provide collateral, but no direct linkage exists between (1) the cash flows from the mortgage loans and (2) the principal and interest payments on the MBBs. The mortgage loans remain on the MBB-issuing financial corporation's balance sheet, but in a segregated portfolio that is monitored by a *trustee* who assures that the market value exceeds the principal amount of the MBBs. In contrast, pass-throughs and CMOs are often originated by selling a mortgage loan portfolio to a *trust* or other type of vehicle company[15] that then issues the asset-backed securities.

4.25 *As a general rule, securitized debt instruments (loans or securities other than shares) should be included in the liabilities on the balance sheet of the asset-backed securities issuer—i.e., the debt-instrument originator or a vehicle company to which the debt instruments were sold—irrespective of whether the holders of asset-backed securities have a direct or indirect claim on the cash flows from the securitized assets.* An exception may apply to stripped securities, depending on whether the PO and CO strips were created by:

- The securities holder that created the strips assuming the liabilities to the PO- and CO-strip holders, and the original security issuer retaining the liability for the unstripped securities; or.

- The original securities issuer's liability for the unstripped securities being replaced by that issuer's liabilities for the PO and CO strips.

The general rule applies in the first case; i.e., the financial corporation that created the strips shows liabilities to the PO and CO purchasers, while continuing to show the asset represented by the original security issuer's obligation. *The exception applies in the second case, which represents the creation of PO and CO strip securities to replace the original securities obligation of the debtor.* The debtor who issues the PO and CO securities may

[15] *Trusts* and other types of *vehicle companies*—often called *special purpose vehicles*—are described in the *MFSM*, ¶72, 100, 102-105, and in Chapter 3 of this guide.

retire the original securities or may leave them in a repository (e.g., a settlement or clearing facility) on a "dormant basis" until such time when the securities are reissued or redeemed. In the meantime, the original securities should be recorded off-balance-sheet (by both the debtor and the repository) to avoid double counting of the debtor's liability. If issued by the original debtor, the strip-like securities are more appropriately viewed as a new issuance of a set of zero-coupon securities, rather than as strips, given that these are stand-alone securities that are not backed by the original securities. *In all cases, the strip (or strip-like) liabilities should be recorded in the appropriate institutional subcategories—i.e., on the basis of residency and economic sector of creditor—within the category of securities other than shares.*

Loans

Loans are financial assets that (1) are created when a creditor lends funds directly to a debtor and (2) are evidenced by non-negotiable documents. ***MFSM*, ¶139.**

Loans that have become negotiable de facto should be classified under securities other than shares. ***MFSM*, ¶ 134.**

General principles

4.26 The general principle that "de facto negotiable" loans should be reclassified as securities other than shares may be difficult to apply in some circumstances. *In this guide, the recommendation is that the reclassification as securities other than shares should be made whenever it is reasonable to expect that a unimpaired loan will be traded in the secondary market. A separate recommendation applies to non-performing or otherwise impaired loans, which should be classified as loans, despite the intent to sell or actual sale of the loans in the secondary market.* The reclassification as securities other than shares applies to both short- and long-term loans and does not depend on whether the time of prospective trading is known or unknown, or on whether the secondary-market sale is expected to take place in the near future or closer to maturity. Some loan contracts contain standardized terms and conditions that are tailored to making the loans attractive for secondary market trading. Such loans are prime candidates for reclassification as securities other than shares. However, secondary markets for loans with more diverse contract features may also exist.

4.27 A secondary loan market is characterized by one or more dealers (or brokers) who stand ready to undertake (or arrange) the purchase and sale of loans on a regular ongoing basis. Strong evidence of the existence of a secondary market is provided by the dissemination of bid-ask price quotations, representing the prices at which the secondary-market maker is prepared to purchase or sell loans with standardized terms and conditions. However, secondary markets may also exist for loans purchased and sold in the absence of bid-ask prices that are widely advertised. Secondary market transactions include the sale of individual loans and loan portfolios.

Impaired loan trading

4.28 Loans sold in secondary markets range from high-quality loans (those with little credit risk) to non-performing or otherwise impaired loans for which repayment is highly uncertain, or even unlikely. Transactions in non-performing or otherwise impaired loans often involve purchases of portfolios of substandard loans at deep-discount prices (i.e., at well below the book value, or carrying amount, of the loans), reflecting the potential default on interest and principal payments for significant proportions of the loan portfolios purchased. *In this guide, it is recommended that a substandard loan that has been purchased at a fraction of book value should be recorded as a loan (valued at the discounted purchase price) and should not subsequently be reclassified as securities other than shares. Similarly, a portfolio of substandard loan assets that potentially may be "factored" (i.e., sold at a fraction of book value) should not be reclassified as securities other than shares*. Even though these loan sales could be classified as secondary-market transactions, it is advantageous to retain the loan classification for these assets to facilitate the future posting of provisions for loan losses, when necessary.

Loan origination and one-time sale

4.29 A financial corporation may specialize in originating loans that are to be sold (usually, shortly after origination) to another financial corporation that intends to hold the loans to maturity. *It is recommended that these loans should not be reclassified as securities other than shares, but rather should be viewed as the product of a two-step loan origination*.

Loan participations

4.30 A *loan participation* occurs when two or more investors (usually, financial corporations) jointly fund a loan to a single borrower, either through a *loan syndication*—a loan origination by a syndicate, or group, consisting of a lead firm and one or more other creditors who jointly fund the loan—or through purchase of portions of an outstanding loan that was originated by one creditor. *Each syndicate member records the amount of the loan participation that member has been funded*.

4.31 A loan participation should be disaggregated by economic sector of the debtor and each creditor. Debtor-creditor relationships for loan participations are determined by legal arrangements. If the loan participation is on an *assignment basis* (the most prevalent type), each participant has a direct creditor claim on the debtor. If the loan participation is on a *non-assignment basis*, the initial contract between a single creditor and the debtor remains intact, but the original creditor incurs a liability to each purchaser of a participation in the loan. The entries for the loan transactions are:

- *Assignment basis*. Each participant classifies the amount of the loan participation as a direct claim on the original debtor. The debtor records the loan participations as individual liabilities, disaggregated by economic sector of the participant. The originator of the loan participation would show a claim on the debtor only to the extent that the originator retained a participation in the loan.

- *Non-assignment basis.* The original creditor/debtor relationship remains intact, and a new set of creditor/debtor relationships is created. The original creditor continues to record a claim on the debtor, and the debtor continues to record a liability to the original creditor—in the full outstanding amount of the loan. In addition, the original creditor records a liability to each participant in the outstanding amount of participation, *classified by economic sector of the participant*. Each participant shows the outstanding amount of the participation as a claim on the original creditor, *classified by the economic sector of the original creditor*.

4.32 *Loan participations that, after initial purchase, are to be held to maturity should continue to be classified as loans. However, if intended for secondary market trading, all syndicate participations should classify the loan participations as securities other than shares*, *resulting in the single classification, as securities other than shares, for the entire syndicated loan*. Collection and disbursement of the interest and principal payments are usually on a *pass-through basis*. The financial corporation that sold the loan participations (or its agent) receives the interest and principal payments from the debtor and, for a fee, passes the payments to the loan participants (even if the seller of the loan participations no longer holds a participation share). Participations that are subject to secondary-market trading are within the broad category of pass-through securities, and those arranged on a non-assignment basis are within the subcategory of asset backed securities.

Trade bills and bankers' acceptances

4.33 A *bill of exchange* is an unconditional order written and signed by one party (drawer of the bill), requiring the party to whom it is addressed to pay on demand, or at a fixed or determinable future time, a specified sum to order or to bearer. Bills of exchange—sometimes called *trade bills* or simply *bills*—are most often associated with foreign trade, but also may be used for domestic trade. Bills of exchange are often called *sight drafts* or *time drafts*, depend on whether payable on demand or payable by a specified future date. A bill of exchange is an *order to pay*, rather than a *promise to pay*. When it is received and "accepted"— stamped[16] and signed—by the party on whom it is written (i.e., the drawee), the bill of exchange becomes a promissory note and is designated as an *acceptance*.[17]

4.34 An *acceptance* is classified within loans or securities other than shares, depending on the characteristics of the credit instrument. *Bankers' acceptances* (*BAs*) are those acceptances that are eligible for rediscounting (i.e., sale) in the secondary market. BAs usually have original maturities of 180 days or less and satisfy requirements that make them eligible for

[16] Traditionally, a stamp and signature were required, but modern drafts may not be stamped.

[17] An ordinary check written on a bank is a bill of exchange that, since payable on demand, is sometimes called a *sight draft*. A bank "accepts" a check by making the ordered payment.

rediscounting.[18] *This guide recommends that those acceptances that are eligible for rediscounting in a secondary market be designated as BAs and classified as securities other than shares, and those ineligible for rediscounting be designated as other acceptances and be classified as loans*. Export credit refinancing facilities of some central banks may provide for the rediscounting of acceptances that are ineligible for trading in the BA market. *This guide recommends that all acceptances eligible for central bank rediscount be classified as securities other than shares.*

4.35 Balance-sheet entries arise from depository corporations' holdings of BAs, other trade bills, and loans made under acceptances.[19] The loans and securities created through acceptances include:

- *Exporter credit.* The drawer (exporter) may hold the acceptance and, at maturity, receive payment (normally channeled through the exporter's bank) from the drawee (importer). The drawer would classify the acceptance as a loan to the drawee, because acceptances are interest-bearing instruments.[20]

- *Export bill*. Instead of holding the acceptance, the drawer (exporter) may rediscount the acceptance at a depository corporation which, in turn, may hold the acceptance to maturity. If ineligible for further rediscounting, the acceptance should be classified as a loan that the depository corporation has extended to the drawee (importer). If eligible for rediscount in the BA market and/or at the central bank, the acceptance should be classified within securities other than shares and, for purposes of sectoral classification, should be attributed to the economic sector of the drawee (importer), who is the original issuer.[21]

- *Import bill.* An importer may arrange an acceptance that calls for the exporter to be paid from the proceeds of a loan that the importer obtains from an other depository corporation that will make the payment. In this case, the other depository corporation is the drawee of the draft. For example, the draft might show "180 days sight," meaning that the bank (drawee) is obligated to pay the exporter at sight–i.e., immediately upon presentation of the draft–and that the bank expects to be repaid

[18] Sight drafts are priced at face value, and time drafts are priced on a discount basis. Resale in the secondary market is called rediscounting of the acceptance.

[19] Depository corporation provide a variety of off-balance-sheet services for bills of exchange and acceptances, including *letters of credit* (*L/Cs*) that support the origination of bills of exchange and cross-border transmission of documentation for the bills and acceptances.

[20] The acceptance would qualify as trade credit in the unlikely event that it were interest-free.

[21] The party that originally accepted the draft has the underlying obligation for the BA. In the event of default by that party, the holder of the BA at maturity has recourse to all other parties in the chain of purchase and resale of a BA.

by the importer in 180 days. The credit advanced to the importer is classified as a loan in the category of *loans made under acceptances*. The loan remains in the depository corporation's loan portfolio until repaid by the importer, but the acceptance—showing the depository corporation's promise to pay the face amount of the draft at maturity—can be sold in the BA market (or possibly rediscounted at the central bank). When the depository corporation rediscounts the acceptance, it records a liability for *own acceptances* within securities other than shares,[22] classified as a liability to the economic sector of the purchaser in the BA market.

- *Banker's acceptances*. Export and import bills that meet the BA eligibility requirements are sold to BA investors, principally to financial and nonfinancial corporations and nonresident institutions. For classification by debtor, the BA should be attributed to the economic sector of the drawee of the bill of exchange. For example, the BA based on an export bill drawn on an importer should be classified within securities other than shares issued by nonfinancial corporations (assuming the importer is a nonfinancial corporation). The purchaser of a BA that originated as an import bill drawn on an other depository corporation should classify the BA within securities other than shares in the subcategory for claims on other depository corporations.

- *Own acceptances*. A depository corporation may repurchase *own acceptances* that it earlier issued in the BA market. Holdings of own acceptances, representing a depository corporation liability on itself, should be deducted from the liability account for *BAs outstanding*. The repurchased own BAs can be reintroduced as a liability, if the depository corporation decides to rediscount them in the BA market during the remaining term to maturity.

Financial leases

Through financial leases, all the risk and rewards of ownership are transferred from the legal owners of goods (lessors) to users of the goods (lessees). Financial leases are classified as loans. ***MFSM*, ¶141.**

4.36 Financial leases (sometimes called capital or full-payout leases) are classified as loans, because financial leases and loans are similar in substance.

Annuities

4.37 In general, an *annuity* is a financial asset for which the purchaser makes a single or series of installment payments that entitle the purchaser to receive fixed or variable payments in the future. From the lender's perspective, an amortized mortgage loan or consumer

[22] These liabilities are designated as *obligations under acceptances, acceptances outstanding*, *own acceptances*, or by some other name.

installment loan can be characterized as a form of annuity. However, *annuities* constitute a distinct category of financial assets that financial corporations—still most prominently, insurance corporations—sell to investors who are accumulating savings for retirement. In many countries, the earnings on annuities are not taxed until the annuity purchaser receives payments from the annuity. The cash flows to be received from annuities are structured in various ways—a lump-sum payment, payments over a specified number of years, payments that cease upon the investor's death, or payments that continue and are paid to the investor's beneficiary.

4.38 Traditionally, annuities have been nontraded instruments with fixed rates, but annuities trading in over-the-counter markets has developed, and variable-rate annuities have become available in some countries. *This guide recommends that nontraded annuities be classified as loans, and annuities designed for secondary-market trading be classified as securities other than shares.*

Credit-card debt

4.39 Credit cards are used by two categories of card holders: (1) those who use the cards strictly as a convenient means of payment for their purchases and (2) those who use the cards as a means of financing their purchases. Card holders in the first category normally do not incur financing charges, if the entire balance due for their credit-card purchases is paid within each monthly billing cycle. The non-interest-bearing obligations incurred by these card holders constitutes a form of trade credit provided by the card issuer. Card holders in the second category, who carry credit-card balances on a month-to-month basis, are charged interest on all outstanding balances, including the balances generated by new credit-card purchases during the month leading up to the billing cycle.

This guide recommends that, if practical, (1) all interest-bearing card balances be classified as Loans and (2) all non-interest-bearing card balances be classified as Accounts receivable/payable – trade credit and advances, which is disaggregated by economic sector (reflecting the use of credit cards by governments and corporations, as well as households). Provision of separate data on interest-bearing card balances is especially important, if weighted-average data for credit-card interest rates are to be compiled for analysis of the demand for credit-card credit.

Shares and other equity

Shares and other equity comprise all instruments and records acknowledging, after the claims of all creditors have been met, claims on the residual value of a corporation. Ownership of equity is usually evidenced by shares, stocks, participations, or similar documents. This category includes proprietors' net equity in quasi-corporations, as well as shares and equity in corporations. It also includes preferred stocks or shares that provide for participation in the residual value on dissolution of an incorporated enterprise. ***MFSM*, ¶165.**

Shares and other equity holdings

4.40 *Shares* (often called *common stock*) of a corporation may be widely held among many investors, closely held among a few investors, held within a single family, or held exclusively by one corporation or an individual. Shares in a corporation may be actively or inactively traded on a securities exchange, traded in an over-the-counter market, or nontraded. Shares are classified within shares and other equity even if the intention to trade them is absent, whereas non-traded securities other than shares are classified as loans. Share holdings of financial corporations include shares of their own subsidiaries, as well as shares of unrelated corporations. Financial holding corporations (see *MFSM*, ¶70) hold shares of subsidiaries (principally, financial corporations) that the holding companies own and control. Subject to national law and regulation, financial corporations may hold shares in depository corporations, other financial corporations, nonfinancial corporations, and foreign corporations. In a few countries, financial corporations (and, in some countries, other investors) hold central bank shares.

4.41 Corporations sometimes purchase their own shares in the market. The reacquired shares (called *treasury shares*) are not classified as asset holdings—i.e., as a financial corporation's claim on itself—but rather are deducted from *funds contributed by owners* within the liability account for shares and other equity.

4.42 *Other equity* is principally in the form of the accumulation of *proprietor's net additions to the equity of quasi-corporate enterprises*—i.e., (1) funds or other resources (including fixed or other assets) that the owners provide for capital investment by quasi-corporate enterprises *less* (2) withdrawals from quasi-corporate enterprises, which include proceeds from the sale of fixed or other assets, transfers of fixed or other assets, and funds taken from accumulated savings and reserves for the consumption of fixed capital. For quasi-corporations, all equity (including retained earnings and reserves) is assumed to be held by the owners. In some cases, the owners may provide quasi-corporation financing through the extension of loans, placement of deposits, purchase of debt securities issued by the quasi-corporation, or provision of trade credit to the quasi-corporation. The owners and the quasi-corporations should record such claims/liabilities as loans, deposits, etc., rather than as additions to the equity of the quasi-corporations.

4.43 In the *1993 SNA* and the *MFSM*, financial transactions related to immovable assets and unincorporated enterprises owned by nonresidents are classified as transactions in shares and other equity. For a quasi-corporation that is a direct investment enterprise wholly owned by nonresidents (e.g., a foreign branch of a domestic financial corporation), it is assumed that all retained earnings of the quasi-corporation (e.g., foreign branch) are treated *as if* the retained earnings were remitted to the parent enterprise (e.g., domestic financial corporation) and then reinvested as a net addition to the quasi-corporation's net equity. If the direct investment quasi-corporation is partly owned by nonresidents, only that portion of retained earnings proportional to the degree of ownership is imputed to be paid and reinvested. The same assumptions are made for incorporated enterprises; retained earnings are assumed to be remitted in proportion to the percentage of the equity owned by nonresidents, and the reinvestment is recorded in shares and other equity.

Shares in investment pools

Investment pools are institutional units that are organized financial arrangements, excluding pension funds, that consolidate investor funds for the purpose of acquiring financial assets. Examples are mutual funds, investment trusts, unit trusts, and other collective investment units. ***MFSM*, ¶100.**

Mutual funds sometimes offer accounts with unrestricted check-writing privileges; these are functionally close to transferable deposits. Mutual fund instruments with these characteristics should be classified as transferable deposits. ***MFSM*, ¶129.**

[Money market funds] . . . invest only or primarily in short-term money market securities such as treasury bills, certificates of deposit, and commercial paper. Shares in some money market funds are transferable and, in such cases, would qualify for inclusion in broad money. Nontransferable shares in money market funds may also be included in broad-money aggregates . . . . ***MFSM*, ¶314.**

[Note: In this guide, the recommended classification as deposits is extended to explicitly encompass all money market fund shares included in the national definition of money. Nontransferable shares in money market funds included in broad-money aggregates should be classified as other deposits included in broad money.]

4.44 Shares in most *investment pools* (also called *investment funds*) are classified as shares and other equity, regardless of the type of assets held by the investment fund—e.g., securities other than shares (*bond funds*), common and preferred shares (*equity funds*), bonds and shares (*hybrid funds*), or mortgages and mortgage corporation shares (*real estate investment trusts,* or *REITs*). An exception is money-market fund shares that are included in the national definition of money and that are to be classified as transferable deposits (if offering unrestricted third-party-payment privileges) or as other deposits (if non-transferable).

4.45 The shares in investment pools are included in shares and other equity, regardless of whether the number of shares is fixed (*closed-end fund*) or varies over time (*open-end fund*).

4.46 Investment pools are organized as corporations, limited partnerships (e.g., many *hedging funds*), special purpose vehicles, or as sets of accounts within depository corporations, insurance corporations, or other categories of financial corporations.

Depository receipts

4.47 Equity shares include *depository receipts* (*DRs*)—securities that evidence ownership of shares in foreign corporations—as well as directly owned shares of corporations.[23] Creation and sale of depository receipts for shares issued in Country A involves several parties: (1) a custodian bank in Country A; (2) brokerage houses in both Country A and Country B (where the DRs will be issued); (3) a depository corporation that is located in

[23] The most common categories are *American depository receipts* (*ADRs*) and *Global depository receipts* (*GDRs*), both most often denominated in U.S. dollars, but sometimes in euros. ADRs are traded on U.S. exchanges such as the New York Stock Exchange and American Stock Exchange, and GDRs are commonly listed on European stock exchanges such as the London Stock Exchange. Other categories are *European depository receipts* and *International depository receipts*. Based on a determined ratio, each DR may be issued as representing a single share of the underlying equity, or more than one share.

Country B and that will issue the DRs in Country B; (4) the investor who purchases the DRs; and, if the DRs are exchange-traded, (4) the stock exchange on which the DRs are listed in Country B.

4.48 Creation of DRs involves the following actions:

- A brokerage house in Country B purchases the equity shares, through its international office or a local brokerage house in Country A, and has the shares delivered to a custodian bank in Country A.[24]
- The custodial bank in Country A verifies delivery of the shares by informing the depository corporation in Country B that its can now the issue DRs.
- The depository corporation in Country B delivers the DRs to the brokerage house in Country B—the party who initiated the creation of the DRs.

4.49 After issuance, DRs can be traded freely among investors, either on a stock exchange or over the counter. The brokerage house that initiated the DRs transfers the securities to a seller—a stock-exchange member or an over-the-counter dealer through a procedure called *intra-market trading*—or the brokerage house sells the DRs directly to investors.

Shares and other equity - liability account for the monetary statistics

In the context of the monetary statistics in Chapter 7 of this manual, financial corporations' total liabilities in the form of shares and other equity are divided into the following separate components:

- *Funds contributed by owners* include the total amount from the initial and any subsequent issuance of shares, stocks, or other forms of ownership of corporations and quasi-corporations.
- *Retained earnings* constitute all after-tax profits that have not been distributed to shareholders or appropriated as general or special reserves.
- *General and special reserves* are appropriations of retained earnings.
- *SDR allocations* are the counterpart to the SDRs that have been provided by the IMF to central banks—the only financial corporations that receive SDR allocations.
- *Valuation adjustment* shows the net counterpart to changes in the value of assets and liabilities on the balance sheets of financial corporations, **excluding those changes in value (i.e., gains or losses) that are recorded in net profit or loss for the period**.

***MFSM*, ¶166.**

[Note: The bolded text does not appear in the *MFSM* and has been added for clarification.]

4.50 In principle, net profit or loss can be transferred to retained earnings in each period, as the profit or loss is recorded. In practice in many countries, net profit or loss is transferred to retained earnings on a quarterly or annual basis. In the periods between transfers to retained earnings, profit or loss is transferred on a cumulative basis to a separate account within shares and other equity. In national financial reporting standards, this account may be designated as *results for the period* or *accumulated profit or loss* or by some other name. In

[24] The custodial bank is a correspondent bank or an oversees branch of the depository corporation issuing the DRs.

the reported data for the monetary statistics, *retained earnings* should include all profit or loss that has accumulated in the current and previous periods, including amounts in accounts such as *results for the period* that have not been officially transferred to retained earnings.

Insurance technical reserves

Insurance technical reserves consist of net equity of households in life insurance reserves and pension funds and prepayments of ***insurance*** *premiums* ***and reserves*** *against outstanding claims.* All these items are considered assets of beneficiaries and policyholders. ***MFSM*****, ¶168, corrected**

General principles

4.51 The category of *insurance technical reserves* is used to account for (1) specific types liabilities issued by insurance corporations (and quasi-corporations) and pension funds and (2) assets in the form of prepayments of insurance premiums that constitute claims on insurance corporations. The term *insurance technical reserves* applies to the liabilities of pension funds, because a pension fund is a form of social insurance scheme. *1993 SNA* states:

> Social insurance schemes are schemes in which social contributions are paid by employees or others, or by employers on behalf of their employees, in order to secure entitlement to social insurance benefits, in the current or subsequent periods, for the employees or other contributors, their dependents or survivors. They may be organized privately or by government units. Social insurance benefits may be provided in cash or in kind. . . . (¶8.55)
>
> A social insurance scheme is one where the policy holder is obliged or encouraged to insure against certain contingencies by the intervention of a third party. For example, government may oblige all employees to participate in a social security scheme; employers may make it a condition of employment that employees participate in an insurance scheme specified by the employer; an employer may encourage employees to join a scheme by making contributions on behalf of the employee; or a trade union may arrange advantageous insurance cover available only to the members of the trade union. . . . (Annex IV, The treatment of insurance, social insurance and pensions, ¶5)

4.52 Social insurance schemes include *social security schemes*, which are schemes that are imposed and controlled by government units, cover the entire community or large segments of it, and generally involve compulsory contributions by employees, employers, or both. Social security schemes are not covered in this chapter.[25]

4.53 This chapter deals mainly with the classification of asset and liability accounts of insurance corporations and pension funds in the financial corporations sector, as reflected in the sectoral balance sheets in the monetary statistics. The accounts within *insurance technical reserves* receive separate treatment, owing to the specialized treatment of these accounts in national financial reporting standards and the macroeconomic statistics. Except for *prepayments of insurance premiums* and *reserves against outstanding claims*, the

[25] For more on social security schemes, see *1993 SNA*, ¶4.111-112; *1993 SNA* Annex IV, ¶34-35 and Table A.IV.1; and *Government Finance Statistics Manual 2001*, Annex to Chapter 2.

accounts within *insurance technical reserves* appear only as liabilities in the balance sheets of insurance corporations or pension funds.

4.54 Insurance corporations disaggregate their asset holdings into separate portfolios for (1) reserve assets—a pool of assets earmarked for meeting the insurance claims of policyholders—and (2) own assets—a pool of assets funded from retained earnings and equity contributions by owners of the insurance corporation and excluded from the calculations pertaining to the wherewithal to meet the future obligations to policyholders. Reserve assets of insurance corporations consist of financial assets such as deposits, loans, and securities, as well as nonfinancial assets such as land and buildings. Insurance corporations' holdings of own assets have the same classifications as those in the reserve asset portfolio—financial assets such as deposits, loans, securities, etc. and nonfinancial assets. Distinguishing between reserve assets and own assets is important for managerial and supervisory analysis of the solvency of insurance corporations. Data on the investment income[26] from the reserve assets are needed for the calculation of property income attributed to insurance policy holders in the context of the national accounts statistics.

4.55 The distinction between *reserve assets* and *own assets* of insurance corporations does not enter into the classification of the financial and nonfinancial assets as presented in the balances sheets for the monetary (and financial) statistics. *For the monetary and financial statistics, the assets of insurance corporations are classified only by asset category—deposit, loan, securities other than shares, shares and other equity, financial derivatives, other accounts receivable, and nonfinancial assets—disaggregated where applicable by national/foreign currency of denomination and by economic sector. For each disaggregated asset category, the total amount outstanding is the sum of the outstanding amounts in the reserve assets and own assets portfolios.* This rule applies to the asset holdings of both life and non-life insurance corporations.

4.56 Similar rules apply to the classification of the assets held in pension funds. Separate rules are specified for two types of private-funded pension schemes:

- *Autonomous pension schemes*. An autonomous pension fund constitutes a separate institutional unit. To qualify as an institutional unit, the pension fund must have its own separate balance sheet and must be managed separately from the operations of

[26] The insurance enterprises receive property income from the financial assets and land, and earn net operating surplus from the renting or leasing of residential and other buildings. "The total of the primary incomes received in this way from the investment of insurance technical reserves is described as *investment income*. It does not, of course, include any income received from the investment of insurance enterprises' own assets. However, as the technical reserves are assets of the policyholders, the investment income receivable by insurance enterprises must be shown in the accounts as being paid by the insurance enterprises to the policyholders. . . . However, this income is retained by the insurance enterprises in practice. It is therefore treated as being paid back to the insurance enterprises in the form of premium supplements." (*1993 SNA*, ¶7.124)

the single employer or multiple employers[27] whose employees are covered by the pension plan. *For the monetary and financial statistics, the assets of an autonomous pension fund are classified by asset category—deposit, loan, securities other than shares, etc. (including nonfinancial assets)—disaggregated where applicable by national/foreign currency of denomination and by economic sector.*[28] *Prepayments of insurance premiums are recorded in the separate asset account within insurance technical reserves.*[29]

- *Non-autonomous funded pension schemes.* A non-autonomous funded pension fund is classified in the same institutional sector as the employer who has organized it.[30] A distinguishing feature is that the pension assets are segregated from the employer's own funds (non-pension-plan assets). The non-autonomous pension plan, though at least partially funded, may be either underfunded or overfunded.[31] *For the monetary and financial statistics, the assets of a non-autonomous funded pension plan are classified by asset category—deposit, loan, securities other than shares, etc. (including nonfinancial assets)—disaggregated where applicable by national/foreign currency of denomination and by economic sector. After appropriate classification,*

[27] As defined IAS 19.7, "*Multi-employer plans* are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that: (a) pool the assets contributed by various entities that are not under common control; and (b) use those assets to provide benefits to employees of more that one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned." As defined in IAS 19.7: "*Defined contribution plans* are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods." IAS 19.7 defines defined benefit plans residually: "*Defined benefit plans* are post-employment benefit plans other than defined contribution plans." A distinguishing feature of defined benefit plans is that the liability for the defined benefits must be estimated on the basis of actuarial principles. Actuarial estimation is not required for a *defined contribution plan*, because the payouts under such plans vary directly with the amount of income generated by the plan's assets, rather than being a predetermined obligation (defined benefit). IAS 19.43 states: "Accounting for defined contribution plans is straightforward because the reporting entity's obligation for each period is determined by the amounts to be contributed for that period. Consequently, no actuarial assumptions are required to measure the obligation or the expense and there is no possibility of any actuarial gain or loss." The accounting for defined contribution plans is equally as straightforward for the monetary and financial statistics.

[28] An expectation to this classification is insurance policies. As defined in IAS 19.7, "*Plan assets* comprise (a) assets held by a long-term employee benefit fund; and (b) qualifying insurance policies." The treatment of insurance policies held as plan assets is covered later in this section of this guide.

[29] In an exceptional case, an employer may have organize more than one pension fund. Application of the accounting rule is directly extendable to multiple portfolios of pension plan assets.

[30] Funding of the pension fund may be provided by employee contributions, employer contributions, or both.

[31] Underfunding occurs when (a) the estimated value of the pension liabilities is greater than (b) the value the segregated assets; overfunding occurs when (a) is less than (b).

the pension-plan assets and non-pension-plan assets is each category are aggregated to record a single category of stock and flow data.[32]

4.57 In contrast to the aggregated data in the monetary and financial statistics, separate data on pension plan assets is required for compiling the balance sheet in the IFRS framework, as indicated in part (d) of IAS 19.54:

> The amount recognised as a defined benefit liability shall be the net total of the following amounts:
>
> (a) the present value of the defined benefit obligation at the balance sheet date . . .;[33]
> (b) plus any actuarial gains (less any actuarial losses) not recognized . . .;
> (c) minus any past service cost not yet recognized . . .;
> (d) minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly. . . .

The data presentation for the monetary and financial statistics differs from the presentation in the IFRS framework with respect to, in the former case, (1) the amalgamation of the pension plan and own-funded assets and (2) the presentation of the defined benefit liability and plan assets on a gross basis, rather than on the net basis specified in IAS 19.54(d).

4.58 A separate category of pension funds is *unfunded pension schemes*, which are those for which the employer has not established a separate portfolio of reserve assets for meeting current and future pension claims. The employer may have earmarked some assets that can be sold or otherwise liquidated to meet the pension claims but, if so, has not segregated these assets from the employer's own funds. Given that pension fund assets are non-existent or at least non-identified, classification of the employer's assets for the monetary and financial statistics is straightforward; *all assets are to be classified by asset category—deposit, loan, securities other than shares, etc. (including nonfinancial assets)—disaggregated where applicable by national/foreign currency of denomination and by economic sector.*

4.59 In this guide, the category of *insurance technical reserves* as specified in *1993 SNA* is expanded in this guide to include the pension liabilities of unfunded, as well as funded, pension schemes. The guide continues to adhere to the institutional delineation of the *insurance corporations and pension fund sub-sector* as defined in *1993 SNA*, ¶4.97:

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[32] For example, suppose that central government securities are included in the portfolio of pension plan assets, as well as in the portfolio of assets purchased with the employer's own funds. For the monetary statistics, central government securities would be recorded in the amount of the sum of the amounts of central government securities in both portfolios. All flow data would pertain to the transactions, valuation changes, and OCVA (if applicable) for the aggregated category. Similarly, suppose that land and building were included among the pension plan assets. These assets simply are combined with the other nonfinancial assets in the same nonfinancial asset category in the employers' accounts for the monetary and financial statistics. In the financial statistics, the aggregation rule applies to employers in nonfinancial sectors, as well as financial corporations.

[33] "The present value of the defined benefit obligation is the gross obligation, before deducting the fair value of any plan assets." (IAS 19.55)

> This sub-sector consists of resident insurance corporations and quasi-corporations and autonomous pension funds. Insurance corporations consist of incorporated, mutual and other entities whose principal function is to provide life, accident, sickness, fire or other forms of insurance to individual institutional units or groups of units.

In accordance with this specification, the methodology in this guide continues to define the subsector as those institutional units that specialize in insurance services and pension obligations. However, the category of *insurance technical reserves* is broaden to encompass the pension-related assets and liabilities of institutional units outside the insurance corporations and pension fund subsector—i.e., employers with non-autonomous-funded or unfunded pension schemes—as well as the autonomous pension funds in the *insurance corporations and pension funds* sub-sector.[34] Insurance technical reserves is a classification that is not used in the IFRSs. However, balance-sheet recognition of employer liabilities for unfunded, as well as funded, pension schemes is included in *IAS 19—Employee Benefits* (see ¶19.49). Pension plans may originate with employers in any institutional sector of the economy, including central, state, or local governments that have pension plans exclusively for government employees or other employee groups—i.e., pension schemes that do not meet the qualifications of social security schemes.[35]

Net equity of households in life insurance reserves

4.60 The *net equity of households in life insurance reserves* account is used to record the present value of the insurance corporation's estimated (actuarial value of) liabilities for future claims by life insurance policyholders. As described in *1993 SNA*, ¶11.90, these liabilities are the counterparts to households' asset holdings in the form of life insurance reserves:

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[34] The broadening of the category of *insurance technical reserves* is a departure from the methodology of *1993 SNA*, but is consistent with anticipated revisions to appear in *1993 SNA Rev. 1* (forthcoming). The methodology in *1993 SNA* excludes the liabilities for unfunded pension schemes from insurance technical reserve, using the following approach: ". . . an employer operating an unfunded scheme is regarded as making an imputed social contribution to the scheme on behalf of the employees. This contribution should be determined by taking into account the composition of the labour force of the employer and the commitment to provide benefits in the future. In practice, however, it is usually set equal in value to the benefits payable in the period under consideration. The imputed contribution forms part of the compensation of employees and is also shown as being payable by the employees to the scheme together with any actual payments by the employees. However, it is not uncommon for unfunded schemes to be non-contributory for the employees. In these cases the payment by the employees to the scheme exactly match the imputed contributions to them by the employer." (Annex IV, ¶37) *1993 SNA* recommends the use of memorandum items: "Unfunded occupational pension schemes . . . are by definition defined benefit schemes. . . . It is recommended that the present value to households of promises by these schemes to pay future pension benefits be shown as a memorandum item . . . [accompanying] the balance sheets as assets of households. Liabilities of equivalent amount may also be shown as memorandum items for the employer sector liable to pay these benefits." (*1993 SNA*, ¶13.88)

[35] State plans are organized by central, state, or local governmental units on behalf of a specific group of workers and, in accordance with IAS 19.37-38, are accounted for in the same way as multi-employer plans. State plans other than those exclusively for government employees are usually defined contribution plans.

> Life insurance reserves consist of reserves against outstanding risks and reserves for with-profit insurance that add to the value on maturity of with-profit endowments or similar policies. Although held and managed by insurance enterprises, life insurance reserves are considered assets of the insured persons or households and not part of the net worth of the insurance enterprises. Life insurance reserves are collectively described as the net equity of households in life insurance reserves.

In the *MFSM* terminology, *net equity of households in life insurance reserves* refers to a liability account of an individual insurance corporation, as well as being used collectively.

4.61 Some insurance contracts include a deposit component, a discretionary participation feature, or an embedded derivative(s).[36] *This guide recommends that, for the monetary statistics, the bundling or unbundling (i.e., separate classification) of the deposit component be based on IFRS 4 — Insurance Contract* which states:

> Some insurance contracts contain both an insurance component and a *deposit component*. In some cases, an insurer is required or permitted to *unbundle* those components:
>
> (a) unbundling is required if both the following conditions are met:
>
> (i) the insurer can measure the deposit component (including any embedded surrender options) separately (i.e., without considering the insurance component).
>
> (ii) the insurer's accounting policies do not otherwise require it to recognise all obligations and rights arising from the deposit component.
>
> (b) unbundling is permitted but not required, if the insurer can measure the deposit component separately as in (a)(i) but its accounting policies require it to recognise all obligations and rights arising from the deposit component, regardless of the basis used to measure those rights and obligations.
>
> (c) unbundling is prohibited if an insurer cannot measure the deposit component separately as in (a)(i). (IFRS 4.10)
>
> . . . .
>
> To unbundle a contract, an insurer shall:
>
> (a) apply this IFRS to the insurance component.
>
> (b) apply IAS 39 to the deposit component. (IFRS 4.12)

4.62 The discretionary participation feature constitutes a financial instrument that, like the guaranteed element in the insurance contract, can be viewed as a liability other than shares and other equity, or can be viewed as equity. IFRS 4.34 stipulates that the issuer of the insurance contract may, but need not, recognize the guaranteed element separately from the discretionary participation feature. *The general recommendation in this guide is that the discretionary participation feature not be classified separately. However, if the discretionary participation feature has been classified as equity, in accordance with a requirement of the*

[36] For more on deposit components in insurance contracts, see IFRS 4.BC42-BC54 and IFRS 4.IG5; on discretionary participation features, see IFRS 4.BC154-BC165; and on embedded derivatives, see IFRS 4.7-9 and IFRS 4. BC 188-BC194.

national financial reporting standards, the discretionary participation feature does not need to be recombined with the guaranteed element as a requirement of the monetary statistics.

4.63 *The recommendation in this guide is that embedded derivatives not be separated from the host instrument, regardless of whether the embedded derivative is closely related or not closely related to the financial asset that serves as the host instrument.* This recommendation applies to embedded derivatives in insurance contracts, as well as those in financial assets such as loans and securities. Further description of embedded derivatives is provided later in this chapter.

Reinsurance

4.64 *The recommendation in this guide is that reinsurance assets not be netted against the insurance liabilities to which the reinsurance relates.*[37] This recommendation is consistent with IFRS 4.14, which states: ". . . an insurer . . . shall not offset . . . *reinsurance assets* against the related insurance liabilities . . . ." The reinsurance assets should be classified in other accounts receivable, and the amount of reinsurance assets should be separately identified (as a memorandum item) for use by regulators, supervisors, or other parties who wish to measure insurance liabilities on a net basis—i.e., insurance liabilities *minus* reinsurance assets.

4.65 The treatment of reinsurance in the *1993 SNA* is contained in Annex IV, ¶27-29, which state:

- "Insurance corporations undertake insurance in two different ways. The first of these is direct insurance with an institutional unit outside the insurance corporation and pension fund sub-sector. The second is reinsurance which is a form of insurance that involves only institutions units classified as insurance corporations and pension funds . . ." (¶27)

- "Reinsurance transactions between resident insurance corporations should be consolidated; non-life direct insurance with non-life reinsurance corporations and life direct insurance with life reinsurance corporations . . ." (¶ 28)

- "When reinsurance takes place between resident direct insurers and non-resident reinsurers or between non-resident direct insurers and resident reinsurers, a complete consolidation is inappropriate. . . . In principle, imports of reinsurance services are estimated as the balance of all flows occurring between resident direct insurers and non-resident reinsurers. . . . Exports of reinsurance services are similarly estimated as the balance of all flows between resident reinsurers and non-resident direct insurers." (¶29)

[37] The recommendation applies to reinsurance coverage for life- and non-life insurance, even though reinsurance is much less prevalent for life insurance contracts.

4.66 Though used in the compilation of the financial statistics, consolidation of reinsurance transactions between resident insurance corporations and consolidation of all flows between resident insurers/reinsurers and non-resident insurers/reinsurers is not applied in the monetary statistics, which contain the unconsolidated balance sheets and associated flows for all resident insurance and reinsurance corporations.

Net equity of households in pension funds

4.67 The *net equity of households in pension funds* account is used to record the present value of the estimated (actuarial value of) liabilities for the payment of current and future benefit to retirees or other beneficiaries. This sub-account of insurance technical reserves is the dominant liability account of an autonomous defined-benefit pension fund. It is also a major sub-account of the liabilities accounts of all other institutional units that have defined-benefit pension plans, either non-autonomous-funded pension plans or unfunded pension plans of financial corporations (including the central bank), public and other nonfinancial corporations, central government (excluding social security schemes), state and local governments, and nonprofit institutions serving households.

4.68 *Net equity of households in pension funds* is measured on a gross basis, *not* the present value of estimated liabilities *less* plan assets. Measurement on a gross basis is not affected by the presence of pension insurance, whether or not the pension insurance contract is a *qualifying insurance policy* as defined in IAS 19.7:

> A *qualifying insurance policy* is an insurance policy issued by an insurer that is not a related party . . . of the reporting entity, if the proceeds of the policy:
>
> (a) can be used only to pay or fund employee benefits under a defined benefits plan; and
>
> (b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:
>
> (i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or
> (ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.

The recommendation in this guide is to treat a pension plan covered by a qualifying insurance policy as a defined contribution plan. This recommendation is in accordance with IAS 19.[38]

[38] IAS 19.39 states: "An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity will have (either directly or indirectly through the plan) a legal or constructive obligation to either: (a) pay the employee benefits directly when they fall due; or (b) pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods. If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan."

4.69 *If an employer has a defined-benefit plan that is covered by insurance that does not constitute a qualifying insurance policy, it is recommended that the pension plan be treated as a defined-benefit plan in the monetary and financial statistics.* For example, transfer of a pension plan to one type of government-sponsored pension guarantee (i.e., insurance) corporation occurs only if the employer having insurance coverage for a defined benefit plan is in financial distress (usually, having already declared bankruptcy). If the pension fund (assets and liabilities) is transferred to the insurer, the pension liabilities are reduced to a fractional share of the post-employee benefits that were originally promised to the employees covered by the pension plan.[39] *It is recommended that potential plan assets that might arise as claims on such a pension insurer be recorded on an off-balance-sheet basis.*

Prepayment of insurance premiums[40]

4.70 Prepayment of insurance premiums is the only category of insurance technical reserves for which there are both asset and liability accounts in the sectoral balance sheet shown in Table 7.1 of the *MFSM*. The asset account is used to record the amount of a financial corporation's prepayments of premiums to insurance corporations for insurance policies that specify an ongoing relationship between the insurer and the policyholder—until such time when the insurance policy is terminated by the insuree or insurer. Excluded are prepayments of premiums for single-event and limited-duration insurance contracts such as title insurance associated with the acquisition of real property, flight insurance purchased by airline passengers, and insurance for domestic or international shipment of goods.[41]

4.71 The category includes prepayments for both life insurance and non-life insurance policies[42] that cover a wide variety of events such as accident, sickness, fire, theft, etc. The

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[39] In this case, the employer does not meet the criterion of operating as a going concern, and the reduction in pension payments may abrogate the employer's legal or constructive obligation for the pension fund. An employer's obligations as a going concern are described in IAS 19.52-53: "An entity shall account not only for its legal obligations under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity's informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees . . . . [I]t is usually difficult for an entity to cancel a plan if employees are to be retained.

[40] These prepayments are similar in some respects to prepayments for some types of goods (e.g., subscriptions to publications) and some types of non-insurance services (e.g., dues for memberships in organizations). Prepayment of insurance premiums are classified separately, in insurance technical reserves, because of the specialized treatment of insurance corporations' output in the national accounts statistics.

[41] Owing to the specialized and short-term nature of these types of insurance, advance payments for insurance coverage are recorded as current expense (insuree) and current revenue (insurer), rather than treating the insurance services and associated payments by the insuree as being spread over time.

[42] In the *1993 SNA* and *MFSM* methodology, *term life insurance* is treated as a form of non-life insurance. According to the *1993 SNA*, Annex IV, ¶1: "A policy that provides a benefit in the case of death within a given period but in no other circumstances, usually called term insurance, is regarded as non-life insurance because as

(continued)

category also includes less common types of premium payments, including those for reinsurance, deposit insurance,[43] and pension insurance. The category includes prepayments that insurance corporations have made to other insurance corporations—for example, a life insurance corporation's prepayments for fire insurance provided by a non-life insurance corporation.

4.72 The liability account for prepayment of insurance premiums, within insurance technical reserves, is used to record the amount of an insurance corporations' obligations for prepayments received from all resident and nonresident policyholders. Prepayments of insurance premiums do not need to be disaggregated by resident economic sector, but do need to be disaggregated into a separate category for resident insurers (i.e., insurance corporation in the other financial corporations sub-sector) and nonresident insurers. Similarly, prepayments in the asset account for insurance technical reserves need to be disaggregated by prepayments made to resident and nonresident insurers, respectively. The disaggregation is needed to facilitate the compilation of total claims on and liabilities to (1) individual economic sectors and (2) nonresidents, as shown in the consolidated surveys compiled from the sectoral balance sheets.

4.73 The *prepayment of insurance premiums* account is used to record prepayments of *actual payments* of premiums. In the framework of *1993 SNA*, technical reserve assets of insurance corporations are treated as assets of the policyholders, and the investment income from these assets is treated as if (1) paid by the insurance corporations to policyholders and (2) paid back to the insurance corporations in the form of premium supplements. *1993 SNA*, ¶7.124 states:

> The income payable by insurance enterprises to policyholders in this way is described as property income attributed to insurance policyholders. However, this income is retained by the insurance enterprises in practice. It is therefore treated as being paid back to the insurance enterprises in the form of premium supplements that are additional to actual premiums payable under the terms of the insurance polices. These premium supplements on non-life insurance policies and on life insurance policies taken out under social insurance schemes are recorded together with the actual premiums in the secondary distribution of income accounts of the units concerned.

The prepayment of insurance premiums account does not contain a component that would be described as prepayment of premium supplements.

Reserves against outstanding claims

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with other non-life insurance, a claim is payable only if a specific contingency occurs and not otherwise. In practice, because of the way in which insurance corporations keep their accounts, it may not always be possible to separate term insurance from other life insurance. In these circumstances, term insurance may have to be treated in the same way as life insurance for purely practical reasons."

[43] A deposit insurance premium usually is calculated as a specified percent of the amount of the outstanding balances in insured deposit accounts.

4.74 Liabilities that life- and non-life insurance corporations incur as *reserves against outstanding claims* are described in *1993 SNA*, ¶11.98:

> Reserves against outstanding claims are reserves that insurance enterprises hold in order to cover the amounts they expect to pay out in respect of claims that are not yet settled or claims that may be disputed. Valid claims accepted by insurance enterprises are considered due for payment when the eventuality or accident that gives rise to the claim occurs—however long it takes to settle disputed claims**.** Reserves against outstanding claims are therefore considered to be assets of the beneficiaries and liabilities of the insurance enterprises."

4.75 In the framework of the IFRSs, disputed insurance claims are a type of liability that meets the definition of a provision, which in IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets* is defined as " a liability of uncertain timing or amount." (IAS 37.10) *The present value of any expected payouts from future settlements of disputed claims should be included in the insurance corporation's reserves against outstanding claims (rather than in provisions – liabilities within other accounts payable – other.*[44]

Financial derivatives

A financial derivatives contract is a financial instrument that is linked to a specific financial instrument, indicator, or commodity, and through which specific financial risks (such as interest rate risk, currency, equity and commodity price risk, credit risk, etc.) can be traded in their own right in financial markets. ***MFSM*, ¶176**.

The two broad types of financial derivatives are forward-type contracts and option contracts. In a *forward-type 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. ***MFSM*, ¶177**.

Financial derivative markets

4.76 The financial markets have spawned a large assortment of financial derivatives in the broad categories of *forward-type contracts* and *options contracts*. Forward-type contracts are divided into (1) *forward contracts*, which are traded in over-the-counter markets, and (2) *futures contracts,* which are traded on organized exchanges. No analogous dichotomy is applied to the options markets. *Options contracts* refers to both exchange-traded and over-the-counter options. A number of standard types of forward-type contracts and options contracts are shown in Table 4.3 and Table 4.4, respectively. Examples of *exotic options*—those with relatively atypical contract terms—are described in Table 4.5.

4.77 Examples of credit derivatives are shown in Table 4.6, and some relatively new types of contracts—energy, weather, and insurance derivatives—are shown in Table 4.7. Valuation

[44] In the methodology of the *1993 SNA* and the financial statistics, "liabilities of uncertain timing and amount" are treated as contingent liabilities (off-balance-sheet items). The treatment of these *provisions* in the monetary statistics is covered in the last section of this chapter.

of financial derivatives and the accounting for stocks and flows from originating, holding, trading, and settling the more common types of contracts are covered in Chapter 5.

4.78 The volume of financial derivatives trading in the over-the-counter (OTC) market is much larger than the volume on the futures and options exchanges, and the typical transaction in the over-the-counter market is also larger. The overall volume and average size of transactions in the OTC markets are boosted by the inclusion of large volumes of forward contracts in the form of interest-rate and currency swaps.

4.79 This guide recommends that, if the counterparty defaults on the performance of an over-the-counter contract, the financial derivative should be reclassified as a loan until the contract is written off. The recommendation would not apply to financial derivatives that are traded on the organized exchanges. The exchanges incurs the direct losses from contract non-performance,[45] and settles on the settlement date, the same as if performance had occurred.

Forward-type contracts (forwards, futures, and swap agreements)

4.80 Forward-type contracts include *futures contracts*—those that are traded on organized exchanges—and *forward contracts*, which are bought and sold in OTC trading conducted through computer-linked networks of dealers or by telephone between financial corporations or between a financial corporation and a nonfinancial corporate client.

Table 4.3. Standard types[1] of forward and futures contracts

Definitions	Underlying instrument (Main price-settlement variable)
Forward contract. An over-the-counter agreement to buy or sell an asset for a predetermined delivery price at a specified future time. *Futures contract*. An exchange-traded agreement to buy or sell an asset for a predetermined delivery price at a specified future time.	*Future and/or forward contracts:* • Currency (exchange rate) • Equity shares in a corporation or corporations (individual share price or stock price index) • Securities other than shares (interest rate) • Gold (gold price) • Other commodity or commodity basket (individual commodity price or commodity price index) • Swap contract (interest rate). A forward agreement to enter into a swap contract at a future time—called a deferred swap or forward swap.
Swap contract. An over-the counter agreement between two parties to exchange future cash flows.	

[45] The exchange members incur indirect costs through their contributions to a fund that the exchange draws upon to cover non-performance of contracts.

• *Interest-rate swap*. Fixed-rate payments swapped for floating-rate payments.	• Notional principal (interest rate)
• *Currency swap*. Payments in one currency swapped for payments in another currency .	• Notional principal (exchange rate)
• *Cross-currency interest-rate swaps.* Fixed-rate payments in one currency swapped for floating-rate payments in another currency.	• Notional principal (interest rate and exchange rate)
• *Equity swap.* One party's swapped payments are based on the performance of a stock price or stock index. The other party's swapped payments can be based on a fixed or floating rate, another stock price, or a stock index.	• Notional principal (stock prices, stock price and interest rate, etc.)
• *Forward rate agreement (FRA).* An over-the-counter obligation that applies a predetermined interest rate to a notional principal amount over a specified future time period. An FRA is equivalent to an agreement in which a predetermined fixed-rate payment is swapped for a floating-rate payment.	• Notional principal (interest rate)
[1] Excluding credit derivatives; see Table 4.6.	

4.81 Forward contracts are not standardized, whereas futures contracts have standard terms as specified by the futures exchanges. Significant differences between forward and futures contracts include:

- *Buyer, seller, and the clearinghouse.* For either a forward contract or a futures contract, the parties that acquire the long position and short position are called the *buyer* and *seller*, respectively. For a forward contract, a buyer and seller directly negotiate the contract and hold the long and short positions with each other. For futures contracts, a clearinghouse (established by the exchange) is interposed between the buyer and seller. The clearinghouse is the counterparty to all future contracts, acting as the seller of all contracts for long positions and the buyer of all contracts for short positions. The position of the clearinghouse nets to zero. All risk of non-performance (i.e., contract default) is borne by the clearinghouse, which is obligated to perform on its side of each contract.

- *Delivery.* A forward contract normally contains an exact delivery date, whereas a future contracts usually specifies an entire month or several days within a month (as specified by the futures exchange) when delivery can be made.

- *Settlement.* Forward contracts normally are settled by delivery of the underlying assets or by cash settlements at the maturity of the contracts, whereas futures are usually closed out prior to maturity. A long or short position in a futures contract is

easily liquidated by engaging in a *reversing trade*—simply by acquiring an offsetting short or long position in the futures contract. The futures exchange nets out the original (long or short) position and the reversing (short or long) position. A zero net position with the clearinghouse results, and need to settle the original or the reversing positions is eliminated.

- *Accumulation of value.* Both forward or futures contracts have zero values at inception. For a forward contract, day-to-day gains or losses in the value of the contract are allowed to accrue until the final settlement of the contract. For a futures contract, the clearinghouse of the futures exchange requires daily *marking to market* (i.e., revaluation of the futures contract on each day that the exchange is open) and *daily settlement*—realization rather than accrual—of any daily gain or loss on the contract. After the daily settlement, the futures contract again has a zero value.

Options contracts

4.82 Options contracts are simply referred to as *exchange-traded options* and *over-the-counter options*. No terminology analogous to the forwards/futures dichotomy is used for options.

Table 4.4. Standard types of options contracts

Definitions	Option contract
Call and put options: • *Call option.* A contract giving the holder the right to buy an asset at a stated price (i.e., the strike price) on or before a certain date. • *Put option.* A contract giving the holder the right to sell an asset at a stated price (i.e., the strike price) on or before a certain date. *American and European options:* • *American call or put option*: Right to exercise at any time during the life of the option. • *European call or put option*: Right to exercise only at expiration. *In-the-money and out-of-the-money options:* • *In-the-money call (put) option.* Strike price above (below) the market price of the underlying asset • *Out-of-the-money call (put) option.* Strike price below (above) the market price of the asset.	*Option contract (strike price variable):* • *Stock option*[1] (market price of a corporation's equity shares) • *Index option* (level of a stock price index) • *Bond option* (market price of corporate or government securities) • *Foreign-currency option* (market exchange rate) • *Option on a futures contract, called a futures option* (market price of futures contract) • *Option on an interest-rate swap contract—also called a swap option,* or s*waption (*fixed interest-rate in the swap contract; strike price can also be stated in terms of the amount of notional principal)

[1] Includes long-term equity anticipation securities (LEAPS).

4.83 The options exchange specifies the standard terms for exchange-traded options. The exchange sets the *size* of a single contract (e.g., one stock option contract equals 100 shares of the stock) and establishes *position limits* and *exercise limits*—the maximum number of option contracts that an investor or investor group can hold on one side of the market and the maximum number of contracts that can be exercised within in a given period. Options

exchanges usually make use of market-makers—individuals who are willing to quote both a bid and an offer price (i.e., asked price) for an options contract. The exchange sets an upper limit on the *bid-offer spread*—i.e., the price differential between the market maker's buy and sell quotations. Strike prices for exchange-traded stock options are not normally adjusted for *cash dividends*, but the exchange makes strike-price adjustments for *stock splits*, *stock dividends*, and *right issues* (i.e., contractual rights for existing shareholders to purchase new-issue corporate shares at a specified price). In competition with the large OTC options market, options exchanges have begun to offer some *flex options*—i.e., contracts with somewhat nonstandard terms. Although all nonstandard contracts can be called *exotic options*, some options contracts are more exotic than others. Flex options are in the relatively less exotic category.

Table 4.5. "Exotic" options contracts: examples[1]

Definitions
Nonstandard American options[2] • Early exercise restricted to specific dates, or to only part of the life of the option.[3] • The strike price varies over the life of the option. *Forward start option*: An option that starts at some future date.[3] *Compound option:* An option on an option—i.e., a call option on a call option, a put option on a call option, a call option on a put option, or a put option on a put option. *Chooser option* (also called an *as you like it option*)*:* an option that, after a specified time, the holder can designate as either a call or a put option. *Barrier option*: If the underlying asset price reaches a specified level, the option (1) ceases to exist (*knock-out option*) or (2) comes into existence (*knock-in option*). *Binary option*: An option with a discontinuous pay-off—e.g., an in-the-money call option that pays a fixed amount, regardless of the differential between the current price and strike price of the asset. *Lookback option*: An option for which the payoff depends on the maximum or minimum price of the asset during the life of the option. *Asian option*: An option for which the payoff depends on the average price of the asset during a predetermined averaging period within the life of the asset.

[1] Characteristics of these and other exotic options, along with valuation methods, are covered in John C. Hull, 2003, *Options, Futures, and Other Derivatives*, Fifth Edition (Upper Saddle River, NJ: Prentice-Hall, 2003), Chapter 19.
[2] Some warrants issued by corporations on their own stock have these features.
[3] Executive stock options often have this feature; right of exercise starts when the options are vested.

4.84 An *American option* can be exercised at any time during the life of the option, whereas a *European option* can be exercised only at expiration of the option contract. The American and European designations pertain only to exercise timing, not to the location in which the options contracts are written. Both American and European options are originated and traded in the U.S. markets. Even though an American option can be exercised earlier,

most in-the-money American call options are exercised at maturity. Earlier exercise of an in-the-money American call option on a non-dividend-paying stock is not economically rational. Prior to maturity, the call option holder obtains the same financial rewards (but not the same downside risk) that would arise from ownership of the shares, while postponing the cash outlay for the share purchase until the end of the options contract.

4.85 The same incentive for postponing the exercise of an American put option does not exist. A put option that is deeply in the money would be exercised early. The cash inflow from exercising the put option (i.e., from selling the underlying asset) can be profitably reinvested during the interim period before the put option would expire.

4.86 Investors often can purchase equity shares by *buying on margin*—i.e., by (1) maintaining a *margin account* for the part of the share purchase price paid in cash (based on initial and maintenance margins, stated as percentages of the market value of the shares) and (2) borrowing the remainder of the purchase price of the shares. Options must be paid for in full when purchased—i.e., cannot be bought on margin (i.e., on credit))—because of the high degree of leverage inherent in the options contracts themselves. *Options writers* are required to maintain funds in margin accounts to cover the risk that they may default on options contracts that are exercised. However, no margin account is required from the writers of *covered call options*—i.e. call options written by investors who already own (outright rather than on margin) the assets to be delivered if the call options are exercised.

4.87 *Employee stock options* are call options that are issued as a form of compensation and as incentives for corporate employees to perform their duties in the best interests of the corporation's shareholders. For many corporations, employee stock options are called *executive stock options*, because they are provided only to senior managers of the corporation. Employee stock options are somewhat similar to other long-term call options (long-term equity anticipation securities—LEAPS—of up to 3-year maturity). In other respects, executive stock options are similar to warrants that corporations issue on their own shares. The life of an employee stock option usually does not start until after a vestment period has elapsed. The recipient of employee stock options may have the right to exercise a vested stock option as of a particular date or at any time prior to, or shortly after, resigning or retiring from the corporation. Exercise of the stock options may result in an increase in the number of corporate shares outstanding, depending on whether the exercise of the options is honored by a corporation by (1) issuing new shares, (2) drawing on own share holdings (i.e., treasury stock), or (3) purchasing its own shares in the stock market for delivery to the option holder.

4.88 *This guide recommends the compilation of separate data on employee stock options within the category of financial derivatives.*[46] The data on employee stock options should be

[46] In the future revision of the *1993 SNA*, the category of *financial derivatives* is likely to be changed to *financial derivatives and employee stock options,* and separate subcategories for financial derivatives and executive stock options are likely to be introduced.

available to compilers of the monetary and financial statistics, either on request or as a memorandum item in the standard format for data reporting. Employee stock options have some characteristics in common with other call options on equity—in particular, the right to exercise at a strike price and at the holder's prerogative after the options are vested. In other respects, executive stock options are distinguished from other call options on shares.

4.89 Regular call options are sold to investors who *provide remuneration* (i.e., payment of option premiums) to call option writers, whereas employee stock options are provided to employees *as remuneration* for services performed and in lieu of additional salary, cash bonuses, or other employee inducements. In the statistical methodology, financial derivatives are specified as tradable and, in particular, as instruments for risk trading between the parties to the contracts. Even if employee stock options are tradable (which is uncommon), origination of the options is not motivated by the desire to trade risk, but rather as a means of compensating employees, usually on a deferred basis and without a direct cash outlay by the corporation. Given their remunerative purpose, employee stock options should be treated as a separate subcategory within financial derivatives.

Credit, energy, weather, and insurance derivatives

4.90 Credit derivatives are financial instruments that are designed for the trading of credit risk—i.e., the risk that bonds, other securities, or loans will decline in value because of deterioration in the credit rating of the debt issuer or, in more dire circumstances, because of default on the debt obligations. Credit derivatives take the form of swap contracts, call options, and put options.

4.91 *Some credit derivatives are similar to other types of swaps and options contracts and therefore are classified as financial derivatives (see Table 4.6). Other credit derivatives—in particular, credit default swaps—are more appropriately viewed as a form of insurance and should be classified as insurance contracts.* In a *credit default swap agreement*, one party provides fixed payments at periodic intervals in exchange for the right to deliver (put) securities or a loan at a specified price, if default on the obligation occurs. A *basket default credit swap agreement* specifies a portfolio of debt obligations for which the right to delivery applies to each obligation for which default occurs. The periodic payments for a credit default swap are equivalent to insurance premiums, and the payoff in the event of a credit default is equivalent to an insurance settlement.

Table 4.6. Credit derivatives: Standard types classified as financial derivatives[1]	
Definition	**Underlying instrument (price and credit variable)**
Swap or options contract: • *Total return swap*. Fixed or floating-rate payments swapped for payments in the amount of the total return on securities such as bonds of a private issuer, where the total return includes both interest payments and unrealized capital gains or losses.	• *Reference obligation*—i.e., a specific bond (interest rate and bond price that may be influenced by a change in credit risk)
• *Credit-spread call or put option.* Payoff dependent upon whether a specific interest-rate spread—e.g., the rate over LIBOR or over a default-risk-free government security rate—is above (call option) or below (put option) a "strike" rate spread.	• Reference obligation (interest-rate that may be influenced by a change in credit risk)
[1] Some types of credit derivatives are classified as insurance contracts.	

4.92 The distinction between a financial derivative and an insurance contract is sometimes blurred. Guidance cannot be provided for classification of each type of contract, given the variety of contracts created since the advent of credit and insurance derivatives. *In this guide, the general principle is that a contract should be classified as an insurance policy (1) if periodic payments under the contract are indistinguishable from insurance premiums, (2) if payoff depends on the occurrence of an event such as a credit default or an act of nature (rather than a change in price or interest rate for the underlying asset), (3) if the potential payoff is indistinguishable from an insurance claim, and (4) if the contract does not contain other swap- or option-type provisions.*[47]

[47] The distinction also may be blurred between a credit insurance contract and a third-party credit guarantee—a contingent liability classified as an off-balance sheet item. If premium payments are made in exchange for the credit guarantee, the contract should be classified as an insurance policy. If no transactions are involved in the absence of a credit-default claim, the guarantee is classified as a contingent liability.

Table 4.7. Energy, weather, and insurance derivatives: examples

Definition	Underlying instrument (Main price or event variable)
Energy derivatives: • *Crude oil or natural gas.* Forward, future, swap, and option contracts for crude oil or natural gas • *Electricity.* Forward, future, swap, and option contracts	• Actual quantity or notional amount, depending on whether the contract is to be settled in cash settlement or through delivery (price of crude oil or natural gas) • Kilowatt hours of electricity (price per kilowatt)
Weather derivatives:[1] • *Temperature.* Forward, future, and option contracts • *Rainfall or snowfall.* Forward and option contracts	• Notional amount (cumulative HDD[1] or CDD[2] during a period) • Notional amount (rainfall or snowfall during a period) [1]*Heating Degree Day (HDD)* is a measure of energy usage required for heating during a day: HDD = max(0, 65- *A*), where *A* denotes the average of the highest and lowest daily temperatures at a specified weather station. [2]*Cooling Degree Day(CDD)* is a measure of energy usage required for cooling during a day: CDD = max(0, *A*- 65).
Insurance derivatives: • *Various over-the-counter alternatives to reinsurance.* • *Exchange-traded insurance futures contracts.* *Example: CAT bond.* Purchase of bonds with above-market yields provided in exchange for bond purchaser's provision of a reinsurance contract.	Notional or actual amounts, depending on the type of contract. (various event variables) Bond principal and/or interest (occurrence of loss from earthquake, hurricane, or other event covered by the reinsurance contract)

[1] This guide uses the IFRS criterion to distinguish weather derivatives from weather insurance. IFRS 4. BC60 states: "The IFRS distinguishes an insurance contract (in which an adverse effect on the policyholder is a contractual precondition for payment) from other instruments, such as derivatives and weather derivatives (in which an adverse effect is not a contractual precondition for payment, although the counterparty may, in fact, use the instrument to hedge an existing exposure)." (See also IFRS 4.BC55-BC59.)

Other accounts receivable/payable

Other accounts receivable/payable include (1) trade credit and advances and *(2) other*. . . .Trade credit and advances do not include loans to finance trade credit, which are classified under the category of loans. The *other* category is used to record all items that need to be reviewed for classification elsewhere, as well as accrued taxes and accrued expenses such as rent, wages, and salaries. The *other* category also includes items such as deferred income and provisions for loan losses and other purposes. ***MFSM*, ¶179.**

Trade credit and advances

4.93 Trade credit and advances are claims (or obligations) that arise from the sale (or purchase) of goods and services for which payment is not yet due. For financial corporations, trade-credit receivables usually are associated with their sale of financial services, given that financial corporations seldom are vendors of goods. Trade-credit payables of financial corporations arise from their acquisition of goods and services provided by nonfinancial corporations, as well as from their purchases of financial services from financial corporations.

4.94 Excluded from the category of *trade credit and advances* are:

- *Claims or obligations arising from transactions in financial assets.* A transaction is recorded at the time of change of ownership, which may precede settlement (payment) for the financial asset by several days or longer. For the recipient of the future payment, the claim is recorded in the settlement accounts within *other accounts receivable – other*. The provider of the future payment records the obligation in the settlement accounts within *other accounts payable–other*.

- *Interest-bearing claims/obligations*. In this guide, trade credit and advances are defined to exclude all interest-bearing claims or obligations. *If explicitly interest-bearing, the claim or obligation should be classified as a loan. However, classification as trade credit is appropriate for claims/obligations for which early-payment discounts can be applied.* Payment terms for some purchases of goods and services are sometimes viewed as containing implicit interest rates, based on cash discounts that are provided for prompt payment. In this guide, the cash discount is viewed as a reduction in the sale price of the good or service, rather than as implicit interest that is avoided by early payment.[48]

- *Trade-credit arrears*. If payment is overdue, the trade-credit provider may extend the payment period as a courtesy to the customer, or may arrange for the trade credit to be converted to an interest-bearing loan. In other circumstances, the trade credit provider may judge that the trade credit is unlikely to be repaid. Uncollectible trade credit is treated as equivalent to uncollectible principal on a loan. *In this guide, it is recommended that trade-credit claims that appear to be uncollectible should be reclassified as loans.* After reclassification, the loan (formerly, trade credit) can be

[48] The trade-credit classification applies even though the implicit interest rate may be substantial. For example, payment terms of "2/10 /net 30" mean a 2-percent discount of the invoice amount, if payment is made within the 10-day discount period; otherwise, the full invoice amount is to be paid within 30 day. By foregoing the discount, the payee obtains a 20-day use of funds at a cost of 2 percent of the invoice amount. The implicit interest rate (uncompounded) is 36.5 percent per annum—i.e., the 2-percent discount multiplied by (365/20), the number of 20-day periods in a year. For "1/10/net 30," the implicit interest rate is 18.25 percent.

treated in the same manner as other impaired loans with respect to provision for loan losses, loan write-off, and expected loan losses (see Chapter 5).

- *Prepayment of insurance premiums*. The *advances* subcategory within *trade credit and advances* applies to advance payments for work in progress and prepayments for goods and services, except for the prepayment of policy premiums for insurance services. The classification of these prepayments as *insurance technical reserves,* rather than as trade credit, is an element of the *1993 SNA* methodology that facilitates the data compilation for the insurance corporation subsector. Prepayments of insurance premiums are a relatively minor category of financial assets for the financial corporations that are policyholders, but are significant liabilities of the insurance corporations that receive the prepayments.

Other accounts receivable/payable - other

4.95 The *MFSM* recommended that *other accounts receivable/payable – other* be disaggregated only into resident and nonresident categories. In this guide, the *MFSM* methodology is revised, and further disaggregation of some accounts within the resident category of *other accounts receivable/payable – other* is now recommended. Further disaggregation by type of financial instrument and/or economic sector of debtor/creditor is recommended for some accounts.

4.96 Various subcategories of accounts within *other accounts receivable/payable – other* are described in this chapter. Some subcategories are combined in compiling the data that are to be reported to the compilers of monetary and financial statistics, as described in Chapter 7 of this guide.

4.97 The major subcategories of *other accounts receivable – other* are:

- Dividends receivable
- Settlement accounts (disaggregated by economic sector)
- Items in the process of collection
- IMF quota subscription (applicable only to the central bank)
- Miscellaneous asset items

4.98 *Dividends receivable* on corporate shares arise from the recording of dividends when the dividends are declared, rather than later when the dividends are paid.[49] When notified that a dividend has been declared, the shareholder records the amount of the dividend receivable.

4.99 *Settlement accounts* are used to account for differences in the time of recording of (1) purchases or sales of financial assets on the *trade dates* when changes of ownership occur and (2) the subsequent payments for the financial assets on the *settlement dates*. Suppose a financial corporation sells securities and receives payment from the securities purchaser on the trade date. The financial corporation records the reduction in its securities holdings and, at the same time, records the corresponding increase in its deposit holdings or reduction in its deposit liabilities (if the securities purchaser made payment from a deposit account at the financial corporation). No entry in a settlement account would be needed. Alternatively, suppose that the financial corporation is to deliver the securities and is to receive payment on a settlement date that is the second day after the trade date. On the trade date, the financial corporation records the reduction in its securities holdings and a corresponding increase in the settlement account within *other accounts receivable – other.* On the settlement date, the financial corporation records the payment received from the securities purchaser and a corresponding reduction in the settlement account.

4.100 The same procedure applies when the financial corporation is the purchaser of securities, except the settlement account is a payable. On the trade date, the financial corporation records the increase in its securities holdings and a corresponding increase in the settlement account within o*ther accounts payable – other.* On the settlement date, the financial corporation records the payment for the securities and a corresponding reduction in the settlement account in o*ther accounts payable – other*.

4.101 The settlement accounts within *other accounts receivable – other* is disaggregated by resident/nonresident category, and the resident category is further disaggregated to show the separate settlement claims on the central bank, other depository corporations, other financial corporations, central government, state and local government, public nonfinancial corporations, other nonfinancial corporations, and other resident sectors. If the stock and flow data for settlements accounts are small in comparison with those for major categories of financial assets and liabilities, data disaggregated by economic sector may not have economic significance, and disaggregation of the settlement account may be deemed unnecessary.

Checks or other types of transferable items are posted directly to depositors' accounts, but these are unavailable for use until after the transferable items have been cleared through the central bank or other type of clearing organization. Such unavailable deposits should be recorded under *items in the process of collection* within deposits excluded from broad money. Exclusion of such deposits from transferable deposits avoids their being double counted in the monetary aggregates, given that these deposits continue to be included in the transferable

[49] This accounting treatment, as recommended in the *MFSM*, accords with IAS 18.30 (c), which states that "dividends shall be recognised when the shareholder's right to receive payment is established."

deposits of the depository corporations on which the items were drawn until the items are collected from these depository corporations. ***MFSM*, ¶306.**

4.102 *Items in the process of collection* are created when a depository corporation receives a check or other transferable item from a customer. The usual procedure is to record the item in the customer's deposit account, along with a contra-entry in *items in the process of collection* within *other accounts receivable – other*. The entry in *items in the process of collection* is reversed after the item has been presented through the clearing system and has been paid by the depository corporation (resident or nonresident) on which it was drawn. The posting to *items in the process collection* in *other accounts receivable – other* is needed unless the item is settled on the day of deposit,[50] or has been recorded on an off-balance-sheet basis.[51]

4.103 The *MFSM* and this guide recommend that the item deposited in the customer's account be classified in *deposits excluded from broad money*, until the proceeds from the collected item have been made available to the depositor on an unrestricted basis. Using this approach, double counting in broad money is avoided. The amount of the item is still included in the payer's deposit account and, therefore, in the broad-money liabilities of the depository corporation on which the item was written.[52] In effect, the recommended approach treats the item *as if* it had not yet been written. In compiling the data for *other accounts receivable-other*, the other depository corporations' data for items in the process of collection need to be divided into separate categories only for resident and nonresident payees.

4.104 An alternative approach would be to treat items in the process of collection *as if* the items already had been collected—i.e., *as if* the items had been paid by the depository corporations on which the items were written. Using this approach, the payee's deposit of the item would be posted to *deposits included in broad money* (even if the payee is not allowed to withdraw the funds from the deposit account until after the item has been settled). To adjust for double-counting of deposits in broad money, the monetary statistics compilers would deduct the items from the deposit liabilities of the depository corporations on which the items were written. To make the adjustments, all items in the process of collection would need to be disaggregated by both (1) economic sector of the payee and (2) economic sector of the payer. Because of the extensive disaggregation, detail data on items in the process of

[50] For example, the item may have been written on the depository corporation that received it, because the payee and payer are customers of the same depository corporation. The propensity for same-day settlement increases over time as countries adopt electronic clearing of collectible items.

[51] Off-balance-sheet recording usually applies only to special items or atypical circumstances. For a few countries, such recording may be a more general practice.

[52] The depository corporation discovers that the item is outstanding only when it is presented for payment through the clearing system.

collection would need to be provided to the monetary statistics compilers on a supplementary basis.

> *Central bank float*, which is shown as a memorandum item on the sectoral balance sheet of the central bank, is deducted from the *transferable deposits* component of *broad money*, with a contra-entry in *other liabilities*. Central bank float represents the amount that the central bank has provided to depository corporations that have sent checks or other items for collection**, even though the central bank has not yet collected from the depository corporation on which the checks or other items were written. *MFSM*, ¶399.**
>
> [Note: The bolded text does not appear in the *MFSM* and has been added for clarification.]

4.105 A special category of *items in the process of collection* arises if a central bank provides advance availability of funds to depository corporations that have sent items to the central bank for collection. In the absence of data adjustment, broad money would be overstated by the amount of *central bank float*—i.e., by the amount of the central bank funds provided in advance of the central bank's collection of funds from the depository corporations on which the items were written. Central bank float need not be shown as a separate category within *other accounts receivable - other* in the sectoral balance sheet of the central bank. As the *MFSM* indicates, *central bank float* needs to be reported as a memorandum item to accompany the sectoral balance sheet of the central bank. Adjustment for central bank float can be made as part of the compilation of the Depository Corporations Survey, as described in Chapter 7 of this guide.

4.106 *IMF quota subscription* is recorded as an asset on the balance sheet of the central bank of the member country. Quota is determined upon admission to IMF membership and is increased periodically under the IMF's General Quota Reviews. Separate data on the IMF quota subscription should be shown under the nonresident category of *other accounts receivable – other* in the sectoral balance sheet of the central bank.

4.107 *Miscellaneous items* are defined in this guide as all accounts not elsewhere classified in the financial corporation's balance sheet. *Miscellaneous asset items* and *miscellaneous liability items* are included in *other accounts receivable – other* and *other accounts payable – other*, respectively. In a national accounting system, some accounts in the miscellaneous categories may be known by names that are different than the descriptors used in this guide.

4.108 In exceptional circumstances, a relatively large transaction may be recorded in *miscellaneous items*. If so, the financial corporation should provide supplementary information on the nature and amount of the transaction, as well as identification of the sector of the transactor (nonresident or, if resident, identified by economic sector).

4.109 Major types of *miscellaneous asset items* often include:[53]

[53] This guide does not provide an exhaustive list of the miscellaneous asset and liability items in national accounting systems.

- *Suspense accounts*. These accounts are used for temporary recording of (1) claims for which proper classification has not yet been determined, (2) claims for which verifications, notifications, instructions, or other documentations are required for completing the transactions, and (3) claims that are under litigation or otherwise in dispute. *It is recommended that a financial corporation clear the items from the suspense accounts as soon as possible.*

- *Deferred tax assets*. This category arises from the accounting for income taxes.[54]

- *Prepayments of taxes, import duties, rent, wages, or other operating expenses.*

4.110 The major subcategories of *other accounts payable – other* are:

- Dividends payable
- Settlement accounts
- Provisions for losses on impaired financial assets
- Accumulated depreciation and accumulated impairment losses on assets
- Miscellaneous liability items

4.111 *Dividends payable* arise from the recording of dividends on the financial corporation's shares at the time when the dividends are declared, rather than when paid.

4.112 S*ettlements accounts* within *other accounts payable – other* show a financial corporation's obligations for payments (on future settlement dates) for financial assets that were purchased (on trade dates). The settlement accounts within *other accounts payable – other* need to be disaggregated into resident and nonresident categories and, within the resident category, by economic sector.

4.113 Provisions for losses on impaired financial assets and accumulated depreciation and impairment losses on nonfinancial assets are recorded in other accounts payable – other. This accounting treatment contrasts with national financial reporting standards and the IAS in which (1) provisions, or allowances,[55] for losses on impaired

[54] Deferred tax assets, which are recognized for the carryforward of unused tax losses and unused tax credits, are covered in IAS 12—*Income Taxes* (¶34-37).

[55] *Provisions* for losses on impaired financial assets are often referred to as *allowance accounts* in national financial reporting standards. However, *provisions for losses* is the terminology that is still widely used outside the accounting profession and is the terminology adopted in this guide.

financial assets and (2) accumulated depreciation and impairment losses on nonfinancial assets do not appear as separate accounts on the balance sheet. The balance-sheet presentations in these accounting standards show the estimated recoverable amounts of impaired financial assets, which are obtained by direct write-down in the amount of the estimated impairment loss or through deduction of provisions for the losses. Similarly, the accounting standards specify that accumulated depreciation and accumulated impairment losses on property, plant, and equipment are to be deducted in the presentation of nonfinancial assets.[56] *This guide recognizes the presentation of nonfinancial assets on this net basis as a fully acceptable alternative to presentation on a gross basis accompanied by a liability account for accumulated depreciation and impairment losses on nonfinancial assets.*

4.114 For the monetary statistics,[57] provisions for losses on impaired financial assets (and provisions for accumulated depreciation and impairment losses on nonfinancial assets, if nonfinancial assets are presented on a gross basis) are presented *as if* these items are liabilities and are classified as *other accounts payable – other*, despite the fact that these items are "internal accounts" rather than liabilities to creditors of a financial corporation. Treatment of these items as liabilities facilitates the presentation of financial assets (and nonfinancial assets, if desired) on a gross basis—i.e., without deduction of these items from the asset accounts on the balance sheet—while still preserving a full set of balance-sheet accounts.

4.115 *Provisions for loan losses* are the main category of *provisions for losses on impaired financial assets*. In this guide, it is recommended that impaired deposits, impaired securities other than shares, defaulted derivative contracts (still in the accounts), and impaired trade-credit receivables be reclassified as loans and that, after reclassification, provisions for loss on these assets be included in *provisions for loan losses*. Provisions for losses on impaired financial assets that have not been reclassified as loans (if any such provisions appear in the accounting system) also should be included in *provisions for losses on impaired financial assets*.

4.116 Major types of *miscellaneous liability items* are:

- *Suspense accounts*. These accounts are used for temporary recording of (1) liabilities for which proper classification has not yet been determined and (2) liabilities for which verification, notification, instructions, or other documentation is required for

[56] See IAS 16.6, IAS 16.30, and IAS 36—*Impairment of Assets* (which does not apply to impairment of financial assets, as covers in IAS 39.58-62).

[57] Provisions for losses on impaired financial assets do not arise in the context of financial statistics based on the *1993 SNA*, which states that "Provisions for bad debt are treated as book-keeping entries that are internal to the enterprise and do not appear anywhere in the System." [*1993 SNA*, ¶10.140]

completing the transactions, and (3) liabilities related to litigation or otherwise in dispute. The category is also used for the recording of any discrepancies that arise from incomplete account reconciliation (including in the consolidation of the accounts of a financial corporation's headquarters and branches). *It is recommended that a financial corporation clear the items from the suspense accounts as soon as possible.*

- *Provisions – liabilities*
- *Deferred tax liabilities*.
- *Accrued wages, rent, or other operating expenses*
- *Accrued taxes*
- *Commemorative notes and coins (central bank only)*

4.117 *Provisions* are defined in IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets* and are referred to as *provisions – liabilities* in this guide. These provisions are unrelated to provisions for losses on impaired financial assets. IAS 37 states:

> A *provision* is a liability of uncertain timing or amount. A *liability* is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. . . . (IAS 37.10)
>
> A provision should be recognized when: (a) an entity has an obligation (legal or constructive) as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognized. (IAS 37.14)

4.118 Under national financial reporting standards based on IAS 37, p*rovisions – liabilities* are not recognized for future operating losses, but are recognized for various types of expected costs such as those arising from (1) the expectation of an unfavorable judgment in a lawsuit, (2) plans for restructuring an enterprise's operations or management, or (3) an onerous contract—i.e., a contract for which the unavoidable costs of meeting the obligation exceed the expected economic benefits (see IAS 37.63-83). Provisions are *present* obligations that are recognized as liabilities on the balance sheet,[58] whereas contingent liabilities are *possible* but not probable obligations, or are present obligations that cannot be reliably estimated (see IAS 37.12-13). Contingent liabilities are off-balance-sheet items.

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[58] In June 2005, the IASB issued an Exposure Draft of Proposed Amendments to IAS 37 *Provisions, Contingent Liabilities, and Contingent Assets.* In the proposed amendments, *provision* as a defined term is replaced by *non-financial liability*, which comprises previously defined provisions and other liabilities.

4.119 *Provisions – liabilities* are not recognized as liabilities in the national accounts framework of the *1993 SNA*, which states:

> (The only "provision" recognized in the System is accumulated consumption of fixed capital.) Only actual current liabilities to another party or parties are explicitly included. When the anticipated liability becomes actual—for example, a tax lien—it is included. (*1993 SNA*, ¶13.22)

4.120 In this guide, *provisions – liabilities* are included in *other accounts payable – other*, if the source data for the monetary statistics are based on national financial reporting standards in which *provisions – liabilities* are recognized on the balance sheet. An exception is disputed insurance claims, which should be rerouted from *provisions – liabilities* to *reserves against outstanding claims* in the liability accounts of insurance corporations. To be usable in the financial statistics, the data from the monetary statistics need to be adjusted to exclude *provisions – liabilities* from *other accounts payable - other*, in accordance with the methodology of *1993 SNA*.[59]

[59] The reduction in *other accounts payable - other*, arising for the removal of *provisions – liabilities*, results in a corresponding increase in *net worth*, where net worth in the *1993 SNA* is defined as total assets *minus* total liabilities (inclusive of shares and other equity).

Annex 4.1. Guidance for Distinguishing Between Deposits and Loans

Deposits

Transferable deposits. A financial instrument through which payments can be made directly to third parties is classified as a transferable deposit regardless of whether the holder is a central bank, other depository corporation, central government, money-holding sector (other financial corporation, state or local government, public nonfinancial corporation, other nonfinancial corporation, or other resident sector), or a nonresident. The only exceptions are transferable deposit accounts that have overdrafts or are impaired (i.e., for which the deposit-taker does not honor the depositor's claim). All overdrafted deposit accounts are reclassified as loans rather than as transferable deposit accounts with negative balances. An impaired deposit is reclassified as a loan to facilitate the posting of a provision for expected loss on an impaired financial asset.

Deposits in broad money. The issue of distinguishing between a loan and a deposit does not arise for a financial instrument that is included in the national definition of broad money. In the methodology of the *MFSM* and this guide, the broad-money components are currency outside depository corporations, deposits, and securities other than shares. In particular, broad money does not include a separate component for loans. Any financial instrument that, in national parlance, is designated or informally described as a loan is classified as an *Other deposit*, if the financial instrument is included in broad money.

Zero-interest deposits. The issue of distinguishing between a loan and a deposit does not arise for a financial instrument that is non-interest bearing. In the methodology of the *MFSM* and this guide, loans are specified as interest-bearing instruments. The only exceptions are zero-interest deposits that are impaired, and therefore are reclassified as loans, and zero-interest trade credits for which payment is overdue. An overdue trade credit is reclassified as a loan, as soon as it becomes overdue (whether or not interest charges are to be levied on the overdue trade credit). The most common category of zero-interest deposits are transferable deposits held by the money-holding sectors. However, zero-interest deposits also may appear as deposits holdings of the central government (in the central bank or other depository corporations), non-interest-bearing reserve accounts that other depository corporations hold at the central bank, or non-interest-bearing transferable deposits that represent a depository corporation's claim on or liability to another depository corporation (including a nonresident depository corporation).

Deposits with non-formula-based variable interest rates. This category pertains to savings accounts. The amount and timing of an increase or decrease in interest rate is at the discretion of the depository corporation in which the deposit is placed. The new interest rate applies to all deposit accounts (new accounts and those of longstanding) in the category. This type of interest-rate mechanism does not exist for loans.

Insured deposits. Deposit insurance is a means of ensuring that depositors (usually only households) will recover all or part of their deposit balances in depository corporations that

have been liquidated. Credit guarantees, which are applied to loans and securities other than shares, are somewhat similar to deposit insurance. However, an insured deposit and a loan subject to third-party guarantee can be distinguished on the basis of the institutional arrangements and the nature of asset coverage. Deposit insurance is provided by an institutional unit—the insuring agency—that specializes in insuring broad categories of depository corporations' liabilities to households. In contrast, credit guarantees apply to an individual loan or loan portfolio (or specific set of securities); i.e., they do not guarantee all loans or securities in a particular class. Loans subject to credit guarantees are a means of ensuring that creditors (primarily, central governments and corporate lenders) are covered in the event of default by a borrower or issuer of securities.

Deposits in the form of money-market mutual shares. Money-market mutual fund (MMMF) shares are classified as deposits, if the shares are included in broad money. MMMF shares excluded from broad money are classified as shares and other equity (along with shares in other mutual funds).

Deposits in the form of shares in credit unions and credit cooperatives. Shares in credit unions and credit cooperatives are included in deposits, if the shares are included in broad money. Otherwise, the shares are classified as shares and other equity.

Deposits in the form of repurchase agreements. Repurchase agreements are classified as deposits, if the repurchase agreements are included in broad money. All other repurchase agreements (and all collateral-based security lending arrangements) are classified as loans.

Margin deposits. Investors hold deposits to meet the daily settlement requirements for financial futures and for other purposes. Margin deposits held at depository corporations are invariably classified as deposits. Margin deposits held at a financial auxiliary are classified as deposits, if the general ledger of the financial auxiliary includes deposit accounts. If not, the financial auxiliary may include the margin deposits in the category of *other accounts payable — other*. In particular, the margin accounts are not classified as loans.

Deposits incorporated in residential mortgage loan contracts. This type of arrangement—called an *offset mortgage*—combines a mortgage loan and one or more deposit accounts that the mortgagee holds at the lending institution. The outstanding balances in the deposit accounts are deducted from—i.e., offset against—the outstanding amount of the mortgage loan so as to obtain the net outstanding amount for calculation of monthly loan payments. Under flexible offsetting arrangements, the deposit offset can be used to reduce monthly loan payments, occasionally skip monthly payments, or accelerate repayments to shorten the effective maturity of the mortgage loan. Under some arrangements, the mortgagee's credit-card debt and other types of non-mortgage borrowing can be consolidated with the mortgage loan and the deposit offset. Despite the account consolidation, the mortgagee/depositor retains access to the deposit accounts and receives monthly statements that show the activity of the individual deposit and loan accounts. For the monetary and financial statistics, the deposit and loan components of the offset mortgage are recorded separately in the categories

of *Deposits* and *Loans*, respectively. Whether the deposits are included in or excluded from broad money depends on the national definition of broad money.

Loans

*Collateralized loans***.** Many business loans, commercial and residential mortgage loans, and consumer loans for the purchase of automobiles and other durable goods are backed by collateral. Loans that investors acquire from securities brokers and dealers are usually collateralized by securities or other financial assets that the investors are purchasing (or by other securities or other financial assets that the investors already hold). Deposit contracts do not include collateral requirements.

Loans with protective covenants. Protective covenants appear in some loan contracts, but not in deposit agreements. Protective covenants may stipulate specific actions that a borrower must take—e.g., maintain at least a specified amount of working capital throughout the life of a loan. Other protective covenants may specify actions that a borrower must *not* take without the lender's approval—e.g., expansion of fixed assets, acquisition of additional external financing, entry into a merger, establishment of a subsidiary, or replacement of the senior management of the borrowing firm.

Loans with supporting balance requirements. Loan contracts sometimes specify that, throughout the life of a loan, a borrower must maintain a required amount (or average amount) of deposits in the depository corporation that makes the loan. No analogous requirements exist for deposits.

Loans backed by letters of credit and or other trade-related documentation. Trade bills, letters of credit, and other trade-related documents are used to facilitate the lending associated with the acquisition of imports (or sometimes domestic goods). Financial instruments backed by such documentation are classified as loans. No analogous arrangements exist for deposits. Credit in the form of bankers' acceptances, which are tradable instruments, should by classified as securities other than shares.

Loans made under commitment. Loan commitments, which at one time were informal credit lines available to corporate customers who kept adequate deposit balances at lending institutions, are now often firm agreements that lay out lending institutions' obligations to provide credit in the future (including the amount of credit available and the interest rate to be charged) in return for customers' payments of fees to guarantee the credit availability. All credit extended under informal credit lines or formal loan commitments (including revolving credit arrangements) are classified as loans. Credit card balances subject to interest charges are classified as loans. The credit limit for a credit card is the commitment, and the interest-bearing credit balance is a loan made under a revolving credit arrangement.

Financial leases. All financial leases are classified as loans.

Annuities. Nontraded annuities are classified as loans. Traded annuities are classified as securities other than shares.

Impaired financial assets. This guide recommends that, to simplify data compilation, all impaired financial assets that are nontradable be reclassified as loans.

Borderline Cases

In an exceptional case, the contract terms and conditions for a financial instrument may be so general that straightforward classification as a loan or deposit is impossible. Such cases are unlikely to arise for financial corporations' deposit and loan contracts with governmental units, nonfinancial corporations, other resident sectors, or nonresidents. Exceptions are more likely for short-term contracts between financial corporations.

Suppose a contract between two ODCs were titled simply as *Contract* or *Agreement* (but not as *Deposit* or *Loan*). Further suppose the contract specified only (1) the amount of funding, (2) the interest rate, and (3) the schedule for interest payments and redemption of the financial instrument. *This guide cannot provide recommendations to resolve the classification issue for such contracts. The only recommendation is that the financial instrument be recorded in the same category—whether as a loan or as a deposit—by both parties to the contract.* Implementation of the recommendation implies that the parties to the contract have been in contact and have agreed on the classification.

Even if the ODCs classified the financial instrument differently, the analytical data in the *Other Depository Corporations Survey, Depository Corporations Survey*, and *Financial Corporations Survey* would be unaffected, because of the data consolidation. In compiling the *Other Depository Corporations Survey* (*ODCS*), all claims/liabilities *between* the ODCs would be netted out, irrespective of the classification of the claims and liabilities as loans or deposits.