

Chapter 4. Classification of Financial Assets and Liabilities

Contents	Page
I. Introduction	2
II. Definition of Financial Assets and liabilities	2
III. Classification of Financial Assets and Liabilities.....	3
A. Monetary Gold and SDRs.....	4
B. Currency and Deposits	6
C. Debt Securities	12
D. Loans.....	19
E. Equity and Investment Fund Shares.....	30
F. Insurance, Pension, and Standardized Guarantee Schemes.....	33
G. Financial Derivatives and Employee Stock Options	38
H. Other Accounts Receivable/Payable.....	47
IV. Cross-Classification of Financial Assets by Sector and Currency	50
A. Cross-Classification by Institutional Sector of Counterparties.....	50
B. Cross-Classification by Currency of Denomination	51
C. Cross-Classification of Monetary Liabilities	52
V. Supplementary Classification of Financial Assets.....	52
A. Classification by Maturity.....	52
B. Classification by Type of Interest Rate.....	53
C. Other Classifications	54
VI. Contingencies	54
 Tables	
4.1 Classification of Major Financial Assets.....	3
4.2. Debt Securities: Some Common Types.....	13
4.3. Debt securities: Some types traded in international markets.....	14
4.4. Standard Types of Forward and Futures Contracts	41
4.5. Standard Types of Options Contracts	44
4.6. “Exotic” Options Contracts: Examples.....	45
4.7. IMF-Related Reserve Assets and Liabilities – Analytical Presentation.....	61
4.8. Fund Accounts: Balance Sheet and Analytical Presentation for a Central Bank Designated as Fiscal and Depository Agency.....	62
4.9. IMF Accounts: Loans and Notes	64
 Annexes	
4.1. Accounts with the IMF	56
4.2. Islamic Financial Institutions and Instruments	67

I. INTRODUCTION

4.1. This chapter describes the principal characteristics of financial assets and other financial instruments and their classification within the framework of monetary and financial statistics. The recommended classification follows that of the *2008 SNA*. This chapter also describes in Annex 4.1 the recommended treatment of accounts with the IMF in monetary statistics, and discusses in Annex 4.2 topics related to Islamic financial institutions and instruments.

4.2. Financial instruments comprise the full range of financial contracts made between institutional units. Financial instruments may give rise to financial claims.

4.3. ***A financial claim is an asset that typically entitles the creditor to receive funds or other resources from the debtor under the terms of a liability.*** Each claim is a financial asset that has a corresponding liability. Equity is regarded as a claim; it represents a claim of the owner on the residual value of the entity.

4.4. Other financial instruments (e.g., financial guarantees and commitments such as lines of credit, loan commitments, and letters of credit) that are contingent or conditional upon the occurrence of uncertain future events are outside the financial assets boundary.

II. DEFINITION OF FINANCIAL ASSETS AND LIABILITIES

4.5. Financial assets are economic assets¹ that are financial instruments. Financial assets consist of claims and, by convention, the gold bullion component of monetary gold. Most financial assets are financial claims arising from contractual relationships entered into when one institutional unit provides funds to another. These contracts are the basis of creditor/debtor relationships through which asset owners acquire unconditional claims on economic resources of other institutional units. The creditor/debtor relationship provides asset and liability dimensions to a financial instrument.

4.6. Gold bullion included in monetary gold is considered to be a financial asset because of its special role in the international financial system as a means of international payments and a store of value for use in reserve assets.²

4.7. In this *Manual*, *provisions* for losses on assets that are internal to the reporting institutional unit are treated as if these are liabilities and are classified under other accounts

¹ Economic assets are resources over which ownership rights are enforced, and from which future economic benefits may flow to the owner.

² Reserve assets are those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate and for other related purposes (such as maintaining confidence in the currency and the economy and serving as a basis for foreign borrowing). (See *BPM6*, paragraph 6.64.)

payable. Such provisions are not recorded in the *2008 SNA*, except in the case of expected losses on nonperforming loans, which appear as memorandum items in the balance sheets.³

III. CLASSIFICATION OF FINANCIAL ASSETS AND LIABILITIES

4.8. The classification scheme of the *2008 SNA* is used to classify financial assets and liabilities in this *Manual*. This classification system is based primarily on (i) the liquidity of the asset that subsumes other more specific characteristics such as negotiability, transferability, marketability, or convertibility; and (ii) the legal characteristics that describe the form of the underlying creditor/debtor relationship. Although not separately identified, these specific characteristics of liquidity play a major role in determining the categories.

4.9. The asset and liability classification facilitates the analysis of transactions and stock positions between institutional units and serves as a framework for assessing the sources and uses of financing and degree of liquidity for these units. This classification is intended to provide broad categories that allow international comparability and the inclusion of new instruments within the broad categories identified in *2008 SNA*.

4.10. The major instrument categories of financial assets as classified in *2008 SNA* that this chapter discusses are shown in Table 4.1 below.

<i>2008 SNA</i>	<i>1993 SNA</i> ⁴
Monetary gold and SDRs	Monetary gold and SDRs
Currency and deposits	Currency and deposits
Debt securities	Securities other than shares
Loans	Loans
Equity and investment fund shares	Shares and other equities
Insurance, pension, and standardized guarantee schemes	Insurance technical reserves
Financial derivatives and employee stock options	Financial derivatives
Other accounts receivable/payable	Other accounts receivable/payable

³ *2008 SNA*, Paragraphs 3.41 and 13.66-13.68.

⁴ Classification of major financial assets in *1993 SNA* is shown for ease of reference.

A. Monetary Gold and SDRs

4.11. Monetary gold and Special Drawing Rights (SDRs) issued by the International Monetary Fund (IMF) are financial assets that are normally held only by monetary authorities.

Monetary Gold

4.12. ***Monetary gold is gold to which the monetary authorities (or others who are subject to the effective control of the monetary authorities) have title and is held as a reserve asset as defined in BPM6 (paragraphs 6.64–92).*** It comprises gold bullion (including gold held in allocated gold accounts⁵) and unallocated gold accounts with nonresidents that give title to claims on the delivery of gold. All monetary gold is included in reserve assets or is held by international financial organizations. Except in limited institutional circumstances when reserve assets may be held by other institutions, gold bullion can be a financial asset only for the central bank or central government. Gold bullion holdings that are not part of reserve assets are classified as nonfinancial assets.

4.13. For gold bullion, there is no corresponding liability. Transactions in gold bullion, excluding those among monetary authorities and international financial institutions, are treated as transactions in nonfinancial assets. When a monetary authority purchases gold bullion for inclusion in reserve assets the gold is *monetized*, resulting in a change in the classification of gold bullion from a nonfinancial to a financial asset (monetary gold). If the monetary authority sells gold bullion that is part of reserve assets to institutional units other than monetary authorities or international financial institutions, the gold is *demonetized*, resulting in a change in the classification of gold bullion from a financial asset to a nonfinancial asset before the transaction in nonfinancial assets is recorded. The treatment of these transactions is discussed in Chapter 5 (paragraph 5.66e).

4.14. An allocated gold account is equivalent to a custody record of title to gold, whereas an unallocated gold account does not give the holder the title to physical gold but provides a claim against the account provider denominated in gold (see also paragraph 4.41). Both allocated and unallocated gold accounts can be opened by any sector or subsector with a financial corporation that offers such services but only allocated gold accounts and unallocated gold accounts with nonresidents that give title to claims on the delivery of gold, both held by monetary authorities, are classified as monetary gold.

Nonmonetary gold

4.15. Gold bullion not held as a reserve asset is not a financial asset and is classified as nonmonetary gold. Nonmonetary gold, which can be in the form of bullion, gold powder, and gold in other unwrought or semi-manufactured forms, or gold coin, may be held as either a store of value or for industrial purposes. In some cases, a central bank may own gold bullion that is not held as a reserve asset and thus should be classified as nonmonetary gold.

⁵ An *allocated gold account* is equivalent to a custody record of title to gold.

4.16. Deposit accounts for nonmonetary gold include allocated accounts and unallocated accounts. Consistent with the *2008 SNA*, this *Manual* classifies allocated accounts for nonmonetary gold as nonfinancial assets, and unallocated accounts for nonmonetary gold as *foreign currency deposits*. The same principle applies to an unallocated account for other precious metal (see also 4.41).

Special Drawing Rights (SDRs)

4.17. ***SDRs are international reserve assets created by the IMF and allocated to its members to supplement existing official reserves.*** The SDR Department of the IMF⁶ manages reserve assets by allocating SDRs among member countries of the IMF and certain international agencies (collectively known as the participants).

4.18. SDRs are held only by central banks (or central governments) and a limited number of international financial institutions that are authorized holders, and are transferable among participants. SDR holdings represent each holder's assured and unconditional rights to obtain foreign exchange or other reserve assets from other IMF members.

4.19. The mechanism by which SDRs are created (referred to as SDRs allocation) and extinguished (SDRs cancellation) gives rise to transactions. These transactions are recorded at gross amount of the allocation and are recorded in the financial accounts of the monetary authority of the individual participant on the one hand and the rest of the world representing the participants collectively on the other.

4.20. SDRs are assets with matching liabilities but the assets represent claims on the participants collectively and not on the IMF. A participant may sell some or all of its SDR holdings to another participant and receive in return other reserve assets, most likely foreign exchange.

4.21. SDR holdings and SDR allocations should be recorded as gross assets and liabilities in the balance sheet of monetary authorities. New allocations of SDRs will, therefore, increase claims on nonresidents (reserve assets) and liabilities to nonresidents (foreign liabilities), initially by the same amount. SDR allocations are classified as *long-term debt liability to nonresidents*.⁷ This classification is based on the following two main debt attributes of SDR allocations: (i) interest is payable on the allocation;⁸ and (ii) if a country left the membership of the IMF or the SDR scheme was ended, it would be required to repay its obligations

⁶ The SDR Department of the IMF, relating to administration arrangement of financial resources, was established to conduct all transactions in SDRs, following the creation of the new international reserve asset by the IMF in 1969. The Articles of Agreement require that the General and SDR Departments be kept strictly separately. This separation reflects the fact that the SDR facility is an entirely separate financial mechanism within the IMF (see *Financial Organization and Operations of the IMF*, Pamphlet Series No. 45 Sixth Edition, 2001).

⁷ In the *1993 SNA* and *BPM5*, the SDR was classified as an asset without a corresponding liability. In *MFSM* (2000), SDR allocations were classified as *shares and other equity*.

⁸ As the rate of interest earned by economies holding SDRs is the same as the rate of interest owed by those with SDR allocations, if the levels of holdings and allocations are equal for an economy, no settlement payment is made.

including any SDR allocations. Annex 4.1 provides more detailed discussion on IMF-related accounts and their treatment in monetary and financial statistics.

B. Currency and Deposits

Currency

4.22. ***Currency consists of notes and coins that are of fixed nominal values and are issued or authorized by central banks or governments.***⁹ Currency is divided into domestic currency and foreign currency, the latter representing claims on nonresident central banks or governments.

4.23. Some countries issue coins, which are held for intrinsic value, or commemorative coins, which are held for numismatic value. If not in active circulation, such coins should be classified as nonfinancial assets rather than as financial assets. Those commemorative coins that differ only slightly from the standard coins in circulation are issued at or near their face value, are fungible with the standard coins in circulation, and the central bank has a liability to redeem them, are classified as financial assets (see also paragraph 6.25).

4.24. Central bank or central government holdings of unissued currency are not financial assets but nonfinancial assets and are valued at cost.

Deposits

4.25. ***Deposits are standard, non-negotiable contracts open to the public at large that allow the placements of variable amounts of funds and the later withdrawal.*** They include all claims on the central bank, other depository corporations (ODCs), 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.

Transferable deposits

4.26. ***Transferable deposits comprise all deposits that are (1) exchangeable for banknotes and coins on demand at par and without penalty or restriction; and (2) directly usable for making third-party payments by check, draft, giro order, direct debit/credit or other direct payment facility.***

4.27. Some types of deposits embody only limited features of transferability. For example, some deposits have restrictions such as on the number of third-party payments that can be made per period and/or on the minimum size of the individual third-party payments. Judgment must be applied in the national context in deciding whether deposits with less-than-full transferability features should be classified as transferable deposits.

⁹ In some countries, commercial banks are able to issue currency under the authorization of the central bank or government.

4.28. A deposit through which direct third-party payments can be made is classified as a transferable deposit regardless of whether the holder is a central bank, other depository corporation, central government, money-holding sector (see 6.74), or a nonresident. The only exceptions are transferable deposit accounts in overdraft or that are impaired (i.e., for which the deposit-taker does not honor the depositor's claim). All deposit accounts in an overdraft position are classified as loans (see also 4.32), and an impaired deposit is considered to have limited features of transferability and is classified as an *other deposit* (see also *SNA 2008*, paragraph 11.54).

4.29. Classification of the following specific financial assets is discussed below for the compilation of monetary statistics.

4.30. Cashier's checks. Depository corporations' (DCs) 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 DC. It is signed by the DC'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 DC on which it is written.

4.31. Bank draft (or teller's check). A DC's customer, less commonly, may purchase a *bank draft* (sometimes called a *teller's check*) that is a check or similar instrument written by a DC against funds in its deposit account at another DC. For a bank draft purchased by one of its customers, a DC should record (1) a reduction in deposits liabilities, arising from a withdrawal from the customer's deposit holdings (or an increase in the DC's currency holdings, if the check was purchased with cash) and (2) a reduction in its deposit holdings at the DC on which the draft was written.¹⁰ A bank draft (or teller's check) should be included within transferable deposit liabilities of the DC on which it is written only when the draft is presented for payment but not yet paid.¹¹

4.32. Deposit overdrafts. Depositors in some countries are authorized to obtain funding 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.

4.33. Traveler's check. Traveler's checks are issued by financial or nonfinancial corporations to provide a medium of exchange with characteristics of both currency and

¹⁰ The DC should record a reduction in its deposit holdings at the other DC, even though the corresponding entry will not be made in the other DC's accounts until the item has been presented for payment through the clearing system.

¹¹ 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. The exclusion from broad money is achieved by default because for a bank draft purchased by one of its customers the DC reduces its deposit liabilities and the DC on which the draft was written includes within its transferable deposit liabilities only when the draft is presented to it.

transferable deposits. One feature of traveler's checks is that they provide a safer way to carry funds than currency as a security feature is provided against lost or stolen checks by the issuing party.¹² A traveler's check should be included within transferable deposit liabilities of the issuing DC. (See also paragraph 6.57.)

4.34. Electronic money is a payment instrument whereby monetary value is electronically stored directly on a physical device or remotely at a server. To qualify as electronic money, the payment instrument must represent *general purchasing power* (i.e., must be useable for purchases of goods and services from a wide range of vendors).

4.35. In comparison with currency, which has only physical security features, electronic money uses cryptography to authenticate transactions and to protect the confidentiality and the integrity of the data processing. One common type of electronic money is the "electronic purse", where monetary value of small amounts is stored on payment cards for use in making small payments. Other examples of electronic money include pre-paid cards, web-based electronic money (such as PayPal, if monetary value electronically stored), and mobile money, which is electronic money accessible via a mobile phone or a mobile device to make direct third-party payments.

4.36. Not all electronic payments involve electronic money. For instance, credit cards or debit cards are not electronic money because no monetary value is stored on them; and store cards or internet-based currency (such as Bitcoins¹³ or gaming money) are not electronic money because these are not widely accepted as a medium of exchange.

4.37. Both FCs and nonfinancial corporations can issue electronic money. Regardless of the issuing sector, electronic money is classified as deposits rather than currency. Electronic money stored on a physical device or remotely at a server that can be used for direct third-party payments, qualifies as a transferable deposit. The recipients of such payments, must forward evidence of ownership of the funds to the issuer for redemption under the closed circulation of electronic money. Open circulation allows the funds to be transferred through a sequence of buyer-to-buyer transactions without involvement of the issuer of the electronic money.

4.38. Data collection is straightforward for electronic money issued under closed circulation by ODCs, given that accounting for transactions and balances for the electronic money and for regular transferable deposits are similar. In the loading of funds to the electronic money device, the ODC depositor acquires "hand-held deposits" in exchange for deposits or currency. The ODCs' transactions with the recipients of the electronic funds are similar to electronic settlements for other types of transferrable items.

¹² Specific checks are given unique check numbers, similar to a normal check. When a lost or stolen check is identified, it is simply canceled and the individual is re-issued a new check.

¹³ Bitcoin also does not meet the definition of a currency as it is not issued or authorized by a central bank or government.

Other deposits

4.39. ***Other deposits comprise all claims, other than transferable deposits, that are represented by evidence of deposit.*** Other deposits include:

- (a) Sight deposits that permit immediate cash withdrawals but are not useable for direct third-party payments.
- (b) Savings deposits.¹⁴
- (c) Fixed-term deposits.
- (d) Non-negotiable certificates of deposits.
- (e) Deposits of limited transferability that are excluded from the category of transferable deposits.
- (f) Transferable deposits that have been posted to depositors' accounts, but cannot be drawn upon until the deposited items (e.g., checks or drafts) have been collected by the depository corporations that accepted them.
- (g) FCs' liabilities in the form of shares (such as issued by savings and loan associations, building societies, and credit unions) arising from members' deposits that are legally or in practice redeemable immediately (but are not useable for direct third-party payments) or at short notice.
- (h) Claims on the IMF that are components of international reserves and are not evidenced by loans or notes.
- (i) Repayable margin payments in cash related to different financial contracts, such as financial derivatives and repos (see paragraphs 4.45–4.47).
- (j) Overnight and short-term repurchase agreements that are included in broad money.¹⁵ (See Chapter 6, paragraph 6.36.)

4.40. Classification of some specific types of other deposits for the compilation of monetary and financial statistics is discussed below.

4.41. Unallocated gold (and other precious metal) deposits. Consistent with the *2008 SNA*, this *Manual* classifies an unallocated gold deposit account as a foreign currency deposit.¹⁶ If

¹⁴ Deposits that are called “savings deposits,” but are equipped with automatic transfer service features, should be classified as transferable deposits.

¹⁵ Repurchase agreements that are not included in broad money should be classified as loans.

¹⁶ ODCs in a few countries offer deposit accounts settled in domestic currency 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 foreign currency deposits.

unallocated gold accounts represent claims only on nonresidents they are classified under *Other deposits – In foreign currency – nonresidents*.¹⁷ The same principle applies to unallocated deposit accounts for other precious metals (e.g., silver or platinum). Unallocated deposit accounts for all precious metals are included in foreign currency deposits, and allocated deposit accounts for all metals, other than for gold held by monetary authorities as reserve assets,¹⁸ are included in nonfinancial assets. Conceivably, deposit accounts could arise for financial claims on unallocated commodities other than precious metals.

4.42. The *2008 SNA* recommends (paragraphs 11.56–57) that inter-bank positions in loans and deposits are shown as a separate category of transferable deposits. The borrowing and lending within the deposit-taking subsector, which may be substantial, is of a different economic significance from their intermediation activities involving other sectors. In monetary statistics, all assets and liabilities are classified by sectors/subsectors of counterparties, including for the central bank and ODCs, so that inter-DC positions are identified fully by type of instrument. Further, memorandum items in the sectoral balance sheets/SRFs for the central bank and ODCs separately identify claims on and liabilities to MMFs, allowing the compilation of inter-bank positions as defined in the *2008 SNA* (see also Chapter 2, Table 2.2). When the parties are uncertain as to whether the inter-bank position is a loan or a deposit, this *Manual* recommends recording it under other deposits.

4.43. Restricted deposits are those for which withdrawals are restricted on the basis of legal, regulatory, or commercial requirements. Such deposit withdrawal restrictions do not include limitations on the early withdrawal of deposits that have agreed maturities. A fixed-term deposit withdrawal prior to maturity may not be allowed, or, if allowed, typically carries a penalty for early withdrawal. Such withdrawal conditions are treated as standard maturity provisions of fixed-term deposits, rather than as restrictions. Examples of restricted deposits include:

- (a) Import deposits that are required of importers in advance of importation.
- (b) Compulsory savings deposits that can be accessed only after a specified period or from which withdrawals may be made only for specified purposes (i.e., home purchase or retirement).
- (c) Judicial deposits paid to a court, in the name and to the credit of such a court.
- (d) Fiduciary deposits, which are placed with an ODC (the recipient) by a trustee, typically another ODC or OFC on behalf of another party (the beneficiary).
- (e) Foreign currency deposits that are blocked (i.e., withdrawal allowed only under certain circumstances or conditions) because of national policies (e.g., rationing of foreign currency).

¹⁷ Gold-denominated deposit account with a direct third-party-payment feature should, however, be classified under *Transferable deposits – In foreign currency*.

¹⁸ Such gold is classified as monetary gold.

- (f) Impaired deposits that are expected to be partially or totally uncollectible, including deposits in financial corporations that are under liquidation or reorganization.

4.44. The nature and the period of restrictions need to be considered in deciding which, if any, types of restricted deposits with restrictions should be included in broad money as discussed in Chapter 6 (paragraphs 6.37–6.47).

Margin deposits

4.45. Margins are payments of cash or deposits of collateral that cover actual or potential obligations incurred. The required provision of margin reflects counterparty risk and is standard in financial derivative markets (also see financial derivative section, later in this chapter). The classification of margins depends on whether they are repayable or non-repayable.

4.46. Repayable margin consists of cash or other collateral which is deposited to protect a counterparty against default risk. Ownership of the margin remains with the unit that deposited it. Although its use may be restricted, a margin is classified as repayable if the depositor retains the risks and rewards of ownership—such as the receipt of income or exposure to holding gains and losses. At settlement, a repayable margin (or the amount of repayable margin in excess of any liability owed on the financial contract) is returned to the depositor. In organized markets, repayable margin is sometimes known as *initial margin*.

4.47. In this *Manual*, repayable margin payments are transactions in *deposits*, not transactions in the associated financial assets (e.g., financial derivatives). Repayable margin deposits made in cash are classified as other deposits (particularly if issued by ODCs and included in broad money) or in other accounts receivable/payable. When a repayable margin deposit is made in a noncash asset (i.e., debt securities), no transaction or a new position in stocks is recorded in the balance sheets because no change in economic ownership has occurred.

4.48. Non-repayable margin payments are transactions in the associated financial assets (e.g., financial derivatives); the payments reduce the financial liability created through the associated financial asset with the contra-entry a reduction in another financial asset (probably in currency or deposit). The receipt of non-repayable margin is recorded as a reduction in the associated financial asset; the contra-entry is an increase in another financial asset (probably in currency or deposit). In organized exchanges, nonrepayable margin (sometimes known as *variation margin*) is paid daily to meet liabilities recorded as a consequence of the daily marking of derivatives to market value.

4.49. In some countries, repayable and non-repayable margins are recorded in a single account, and it may be difficult to distinguish. The institutional arrangements (i.e., the identities of units making payments and types of instruments used) must be reviewed. The key test is whether the margin is repayable or whether payment of the margin represents an effective transfer of ownership between counterparties to the financial contract.

Reserve deposits

4.50. Reserve deposits are deposits at the central bank that ODCs use to satisfy reserve requirements. All reserve deposits of ODCs that satisfy reserve requirements, including any excess reserves,¹⁹ based on the averaging of reserve holdings (as well as used for settlement purposes) are classified as transferable deposits unless they are illiquid. Reserve deposits that are pre-specified fixed amounts of required reserves (without averaging of reserve holdings), including excess reserves, are classified as other deposits (i.e., nontransferable deposits). (See also paragraphs 6.95–6.100 and Annex 6.3.)

C. Debt Securities

4.51. ***Securities are financial claims that have the characteristic feature of negotiability.*** In this *Manual* (and the 2008 SNA and other statistical manuals), a financial asset is negotiable if its legal ownership is readily capable of being transferred from one unit to another unit by delivery or endorsement. Securities are negotiable instruments that are designed to be traded usually on an organized exchange or in the over-the-counter (OTC) market.²⁰ The OTC market involves parties negotiating directly with one another, rather than on a public exchange. Some securities may be legally negotiable, but there is not, in fact, a liquid market where they can be readily bought or sold. Negotiability is a matter of the legal form of the instrument, and evidence of actual trading is not required.

4.52. Securities include debt securities and equity securities. Debt securities are discussed in this subsection, and equity securities are discussed in subsection on *Equity and investment fund shares* below.

4.53. ***Debt securities are negotiable instruments serving as evidence of a debt that units have obligations to settle by means of providing cash, a financial instrument, or some other item of economic value.*** They include bills, bonds, notes, negotiable certificates of deposit, commercial paper, debentures, asset-backed securities, and similar instruments normally traded in the financial markets.²¹

4.54. Common types of debt securities are those sold on:

- (a) a coupon basis, stipulating that periodic interest, or coupon, payments will be made during the life of the instrument and that the principal will be repaid at maturity;
- (b) an amortized basis, stipulating that interest and principal payments will be made in installments during the life of the instrument;

¹⁹ Excess reserves are deposits held at a central bank in excess of those required.

²⁰ For a detailed discussion of debt security features see *Handbook on Securities Statistics*, paragraphs [2.7 and 2.8].

²¹ The *Handbook on Securities Statistics* (jointly published by BIS, ECB, and the IMF) deals with the conceptual framework for the compilation and presentation of securities statistics, elaborating on issues such as securities' issuers, holders, currency, maturity, and type of interest rate.

- (c) a discount, or zero coupon, basis, whereby a security is issued at a price that is less than the face (or par) value of the security, and all interest and principal are paid at maturity; a deep discount basis, whereby a security is issued at a price that is less than face value, and the principal and a substantial part of the interest is paid at maturity; or
- (d) an indexed basis, which ties the amount of interest and/or principal payment to a reference index, such as a price index or an exchange rate index, or to a price of a commodity (e.g., gold).

4.55. Table 4.2 shows examples of some common types of debt securities. Table 4.3 presents examples of debt securities issued and traded in international markets.

Table 4.2. Debt Securities: Some Common 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 government
- Commercial and financial paper issued by financial and non-financial corporations
- Negotiable certificates of deposit issued by ODCs
- Bankers' acceptances

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

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

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

Debentures: unsecured or uncollateralized debt security which is backed only by the creditworthiness of the issuer

Debt securities with embedded financial derivatives

- Denominated in a foreign currency¹
- 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 financial derivatives.

4.56. ***Bills are debt securities that give the holders the unconditional rights to receive stated fixed sums on a specified date.*** Bills are generally issued with short-term maturities at discounts to face value that depend on the rate of interest and the time to maturity and are usually traded in organized markets. Examples of such short-term securities are treasury bills, negotiable certificates of deposit, promissory notes, bankers' acceptances, and commercial paper.

4.57. ***Bonds and debentures are long-term debt securities that give the holders the unconditional right to fixed payments or contractually determined variable payments on a specified date or dates, that is, the earning of interest is not dependent on earnings of the debtors.*** Bonds and debentures also give holders the unconditional rights to fixed sums as payments to the creditor on a specified date or dates.

Table 4.3. Debt securities: Some types traded in international markets¹

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. International bonds are those issued outside the domestic market of the borrower.

- *Global bonds.* Simultaneously placed in the Euro and one or more domestic markets with securities fungible between the 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 FCs.
- *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.

4.58. The following paragraphs discuss the classification of some specific types of debt securities for the compilation of monetary statistics.²²

4.59. **Negotiable loans.** Loans that have become negotiable from one holder to another are to be reclassified from loans to debt securities under certain circumstances. For such reclassification, there needs to be evidence of secondary market trading, including the existence of market makers and frequent quotations of the instruments, such as provided by bid-offer spreads.

²² Appendix I of *External Debt Statistics Guide for Compilers and Users (2013)* provides detailed information on specific types of financial instruments and transactions and their classification in the gross external debt position.

4.60. Preferred shares. Nonparticipating preferred stocks or shares (also called preference shares) that pay a fixed income but do not provide for participation in the distribution of the residual value of an incorporated enterprise on dissolution are included in debt securities. Convertible bonds are fixed interest rate bonds that may be converted into equity and should also be classified as debt securities prior to the time that they are converted.

4.61. Bankers' acceptance are treated as financial assets from the time of acceptance (even though funds may not be exchanged until a later stage) and classified under the category of debt securities. A banker's acceptance involves the acceptance by an FC of a draft or bill of exchange and the unconditional promise to pay a specific amount at a specified date. A banker's acceptance must be tradable. The banker's acceptance represents an unconditional claim on the part of the holder and an unconditional liability on the part of the accepting FC; the FC's counterpart asset is a claim on its customer. (See also *Bills of exchange and acceptances* in the subsection on loans.)

4.62. Private placements of debt securities involve an issuer selling debt securities directly to a small number of investors without public offering. The creditworthiness of private placements is not assessed by credit rating agencies and as the securities are generally not resold or re-priced, their secondary market is thin. To the extent that some private placements can be (and are) traded among investors, the criterion of negotiability for debt securities is met.

4.63. A structured debt security combines a debt security, or a basket of debt securities, with a financial derivative, or a basket of financial derivatives. This financial derivative, or the basket, is embedded in and is, therefore, inseparable from the debt security. When the debt security and financial derivative components of a financial instrument are separable from each other, they should be classified accordingly; but if they cannot be separated, then the instrument should be valued and classified according to its primary characteristics, either as a debt security or financial derivative.²³

4.64. Depository receipts (DRs)²⁴ allow a nonresident institutional unit to introduce its equity or debt into another market in a form more readily acceptable to the investors in that market. A resident deposit-taking corporation will acquire the underlying securities and then issue receipts in a currency more acceptable to the investor. After issuance, DRs can be traded freely among investors, either on a stock exchange or over the counter. DRs are classified according to the underlying financial instrument backing them (i.e., as debt securities or equity securities (see also paragraph 4.140)). This is because the "issuer" (the deposit-taking

²³ For more detailed discussion on structured debt securities see the *Handbook on Securities Statistics*, Annex 1.

²⁴ 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.

corporation) does not take the underlying securities onto its balance sheet, but rather acts as a facilitator.

4.65. Promissory notes are unconditional promise to pay a certain sum on demand on a specified date. Promissory notes are one specific type of debt securities within the category—*bills*, which give holders the unconditional rights to receive the stated sums on a specified date. Bills are issued and usually traded in organized market at discounts to face value depending on the rate of interest and the time to maturity.

Debt securities issued through securitization

4.66. *Securitization involves the issuance of debt securities that are backed by financial assets (such as mortgage loans, claims on credit card holders, car loans, commercial and industrial loans), nonfinancial assets, or future income streams (such as from music record sales or ticket sales) that are not recognized as an asset in macroeconomic statistics.*

Securitization of these assets provides liquidity in assets that are otherwise not so liquid. For example, an originating mortgage lender could sell a portfolio of loans to a special purpose vehicle that issues units sold to investors. In cases in which the originator issues asset-backed securities on its own books, the securitization may take place without the creation of a separate entity.

4.67. Asset-backed securities and collateralized debt obligations (CDOs) are arrangements under which payments of interest and principal are backed by payments on specified assets or income streams. Asset-backed securities may be issued by a holding unit or vehicle to raise funds to pay the originator for the underlying assets. Asset-backed securities are classified as debt securities because the security issuers have an obligation to make payments, while the holders do not have a residual claim on the underlying assets.

4.68. The following paragraphs discuss some specific types of debt securities issued under securitization schemes.²⁵

4.69. Pass-through securities are backed by a package of assets. A pass-through security derives its name from the fact that the payments arising from the underlying assets are passed straight through to the holders of the debt security. Pass-through securities that are backed by fixed-rate mortgage loans are a prominent type of asset-backed securities. An FC that originates residential mortgage loans may pool some of these assets and sell portions of the mortgage loan pool to investors. The assets 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.

²⁵ The *Handbook on Securities Statistics* provides a description of three broad types of securitization schemes and the range of debt securities issued under these schemes.

4.70. Collateralized mortgage obligations (CMOs) are a type of mortgage-backed security that are designed to attract investors who have differing preferences for prepayment risk.²⁶ The distinguishing feature is that the securities issued as a CMO are divided into different 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.²⁷

4.71. 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 the cash flows from the mortgage loans, and the principal and interest payments on the MBBs. The mortgage loans remain on the MBB-issuing FC'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 company²⁸ which issues the asset-backed securities.

4.72. Credit-linked notes (CLN) are debt securities backed by reference assets, such as loans and bonds, with an embedded credit default swap (CDS) allowing credit risk to be transferred from the issuer to investors. Repayment of principal and interest on the notes is conditional on the performance of the reference assets. If no default occurs during the life of the note, the full redemption value of the note is paid to investors at maturity. If a default occurs, then investors receive the redemption value of the note minus the value of the default losses. The CDS is regarded as an integral part of the bond and is not separately classified and valued.

4.73. A covered bond is a debt security with a claim on the issuer and, if the issuer defaults, on a cover pool of high-quality collateral (which the issuer is required to maintain). Covered

²⁶ A CMO is distinguished from a collateralized debt obligation (CDO). Although both are designed with tranches for investors with different preferences for risk, CDO is a structured financial product that pools cash flow-generating assets (collateral for the CDO) and repackages the asset pool into discrete tranches for sale to investors. The investors in each CDO tranche contract for a portion of the credit risk which is allocated to CDO tranches in the same manner that prepayment risk is allocated to CMO classes.

²⁷ 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.

²⁸ *Trusts* and other types of vehicle companies—often called special purpose vehicles—are described in Chapter 3 (see paragraphs 3.25–3.31 and 3.173).

bonds are issued under specific legislation (or contracts which emulate this). The recourse to the pool of collateral and consequent reduction in credit risk transfer distinguishes covered bonds from asset-backed securities.

4.74. As a general rule, securitized debt instruments (e.g., loans or debt securities) 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. The financial assets (e.g., the mortgage loans or debt securities) that back the securities continue to be shown on the asset side of the balance sheet. An exception may apply to stripped securities discussed in the next paragraph.

4.75. Stripped securities are securities that have been transformed from a principal amount with coupon payments into a series of zero-coupon bonds with maturities matching the coupon payment date(s) and the redemption date of the principal amount(s). They are also called ‘strips’. The function of stripping is that investor preferences for particular cash flows can be met in ways different from the mix of cash flows of the original security. Stripped securities may have an issuer different from the original issuer. There are two cases of stripped securities:

- (a) when no new funds are raised and the payments on the original securities are stripped and separately marketed by the issuer or through agents (such as strip dealers) acting with the issuer’s consent; and
- (b) when a third party acquires the original securities and uses them to back the issue of the stripped securities. New funds have been raised and a new financial instrument is created.

4.76. FCs purchase bonds or similar instruments, strip the coupon payments, and sell 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 PO- and CO-strip investors receive the cash flows from the bonds on a pass-through basis. The issuer of the strip (FC) records liabilities (classified under debt securities) for the cash flows that were stripped and sold. FCs are purchasers, as well as creators, of PO and CO strips.

4.77. 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 IO strips, similar to those for other pass-through securities backed by mortgage loans, reflect the pattern of the loan payments.

4.78. When the issuer of the original security creates PO and CO strips, the original security issuer retires the original securities or leaves 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. The strip-like securities replace the original securities to avoid double counting of the issuer’s liabilities.

Indexed securities

4.79. Indexed debt securities are instruments for which either the coupon payments (interest) or the principal or both are linked to an index such as a price index or the price of a commodity. These securities are classified as variable-rate instruments. The recording of revaluations and interest for indexed debt securities is discussed in Chapter 5 (paragraphs 5.53–5.59 and Annex 5.2, paragraph 5.269).

D. Loans

4.80. *Loans are financial assets that are (1) created when a creditor lends funds directly to a debtor, and (2) evidenced by documents that are not negotiable.*²⁹

4.81. The category of loans includes overdrafts, installment loans, hire-purchase credit and loans to finance trade credit. Claims on, or liabilities to, the IMF that are in the form of loans are also included in this category.³⁰ An overdraft arising from the overdraft facility of a transferable deposit account is classified as a loan. Repurchase agreements, gold swaps, and financing by means of a financial lease may also be classified as loans, as explained in the remainder of this subsection. Undrawn lines of credit are not recognized as an asset as they are only potential claims. Accounts receivable/payable which are treated as a separate category of financial assets, and loans that have become debt securities are also excluded from loans.

4.82. Classification of some specific financial instruments for the compilation of monetary statistics is discussed below.

Repurchase Agreements and Securities Lending

4.83. *A securities repurchase agreement (repo) is an arrangement involving the provision of securities in exchange for cash with a commitment to repurchase the same or similar securities at a fixed price either on a specified future date (often one or a few days hence, but also further in the future) or with an “open” maturity.*³¹ A repo is viewed from the perspective of the provider of the securities (i.e., “the cash taker”). The agreement is called a *reverse repo* when viewed from the perspective of the securities taker (i.e., the “cash provider”).

4.84. Repos convey the legal ownership of the securities to the cash provider which entitles the cash provider to on-sell (i.e., to sell the securities to a third party). Despite conveyance of the legal ownership to the cash provider, the economic ownership is retained by the cash taker (i.e., the securities provider), as the cash taker retains the market risk and ownership benefits,

²⁹ Negotiability is defined in paragraph 4.51. Loans may be traded, but their legal form is not designed for negotiability in the same way as debt securities.

³⁰ Detailed discussion on IMF-related accounts is contained in Annex 4.1 of this chapter.

³¹ “Open” maturity is where both parties agree daily to renew or terminate the agreement. Such an arrangement avoids settlement costs if both parties wish to rollover the repo on a continuing basis.

other than the right of sale, including holding gains or losses and interest income on the securities. Because of these features, a repo is similar to a loan that is collateralized by the securities underlying the agreement.

4.85. Repos may be used for a variety of different purposes, for example, as a means of financing the acquisition of the underlying instrument; for cash borrowing; or as a means of covering a negative position (“short” position) in the security. In some circumstances, substitution of the securities may be permitted;³² also a margin deposit is often provided as added protection against adverse movements in the price of the security. Repurchase agreements are usually “cash-driven,” (i.e., the motivation is to obtain cash (with the security provided as collateral)) but they may be “security-driven” where the motivation is to obtain a security when it has “gone special” (i.e., when it has become difficult to obtain). If provided, margin is usually paid by the party initiating the transaction, regardless of whether it is cash- or security-driven.

4.86. A buy-sell-back is one type of repo, which involves a spot sale of a security with a simultaneous forward purchase. Buy-sell-backs have the same economic effect as a securities repo. The main difference between the two arrangements is that in a repo both transactions are conducted under the same frame contract whereas under a buy-sell-back, the transactions are conducted under two different contracts.

4.87. This *Manual* (and the *2008 SNA* and other statistical manuals) recommends that securities repurchase agreements be treated as collateralized loans or deposits rather than as outright sales of securities. A repurchase agreement is generally classified as a loan, but is classified as an other deposits if it involves the liabilities of DCs and is included in the broad money. The securities should remain on the balance sheet of the cash taker and a new financial asset (i.e., a loan or a deposit) should be recorded as an asset of the cash provider and a liability of the cash taker.

4.88. Securities acquired under reverse repo may in turn be repoed. In such circumstances, the securities under repo support two loan transactions—the cash provider’s claim on the cash taker under the original repo and the claim of the “on-buyer” (i.e., the cash provider under the new repo) on the original cash provider (i.e., the cash taker under the new repo who is also the cash provider under the first repo/reverse repo). The party with the loan asset from the reverse repo does not net it against the loan payable in the subsequent repo, because the counterparties to the two transactions are different. Double-counting of the holding of the security should not arise in such a case, because the securities underlying both the first and the second repos continue to be recorded only on the balance sheet of the original cash taker.

4.89. This *Manual*, consistent with the *2008 SNA* and other statistical manuals, makes a specific recommendation on the statistical treatment of securities which are acquired under reverse repo and are on-sold outright. Although a cash provider should not record the

³² Similar securities can be substituted if permitted under the agreement. "Similar" may be defined narrowly or broadly, depending on the circumstances.

acquisition of a security under a reverse repo as a transaction in securities, if the security so acquired is on-sold outright a transaction in the security should be recorded by the cash provider (and by the outright purchaser). This is known as “short selling”³³—the sale of a financial asset not currently held on-balance sheet—and results in a recorded “short” position in the security for the on-seller.³⁴ This treatment reflects the economic ownership in that the holder of the negative position is exposed to the risks and rewards of the security, in an equal and opposite way, as the party in a long position. Interest accrues on the negative position negatively (i.e., the negative position becomes larger). The recording of a negative position overcomes the double counting, in aggregate, which would otherwise result from the security being recorded as an on-balance sheet asset holding of the third party that has purchased it outright, as well as still being recorded on-balance sheet as a security asset holding of the cash taker under the repo.

4.90. In this instance, additional information may be required for a fuller understanding of the repo market and to determine who is holding the instrument. It is useful for the analysis of liquidity, leverage and vulnerability, to identify the parties to repo transactions. Accordingly, it is recommended that when a repo (reverse repo) is undertaken, data on the counterparty to the repo (reverse repo) transaction (resident sector or nonresident) and the instrument and sector of issuer (e.g., government debt security) are made available to the compilers, for ensuring appropriate recording in sectoral balance sheets.

4.91. ***Tri-party repo is a transaction for which post-trade processing—collateral selection, payment and settlement, custody and management during the life of the transaction—is outsourced by the parties to a third-party agent.*** Because the third party is only an agent, use of a tri-party arrangement does not change the relationship between the parties, as the agent does not take any risk. If one of the parties defaults, the impact still falls entirely on the other party. Nor does the tri-party agent provide a trading venue where the parties can negotiate and execute transactions. Instead, once a transaction has been agreed—using an independent automatic repo trading system or directly by telephone or electronic messaging—both parties independently notify the tri-party agent, who matches the instructions and, if successful, processes the transaction.

4.92. ***Securities lending refers to an arrangement whereby a security holder transfers securities to a “borrower,” subject to the stipulation that the same (or similar)³⁵ securities be returned on a specified date or on demand.*** “Full, unfettered ownership” is transferred to the “borrower,” but the risks and benefits of ownership (economic ownership) remain with the

³³ This treatment should be applied to the recording of all short sales of securities, whether or not associated with repos.

³⁴ The relevant security asset category may record positive holdings if other securities of that category are held on-balance sheet to a greater value than those that have been sold “short”.

³⁵ Similar securities can be substituted, if permitted under the lending arrangements. “Similar” may be defined narrowly or broadly, depending on the circumstances.

original owner.³⁶ The practice is undertaken by owners of securities to raise the return on the securities and/or to reduce the cost of custody.

4.93. Securities lending arrangements are divided into two major categories that are delineated by the type of collateral—either cash or securities—that is provided to the lender of the securities.³⁷ The borrower of the securities usually provides collateral that is of equal value to, or greater value than, the value of the securities being lent.

4.94. Securities lending that is backed by cash collateral is similar to a repo, has the same economic effect as a repo and so, is treated statistically in the same way.

4.95. Securities lending that is backed by non-cash collateral (or that is not collateralized) should be recorded off-balance sheet by both the lender and borrower of the securities, rather than be treated as a transaction. If the securities are on-sold outright to a third party, the “borrower” of the securities should record a security transaction, and a reduction in security assets, resulting in a “short” position in that security asset. Similar to repos, this approach overcomes the double counting that would otherwise result, in the aggregate, from the security being recorded as an on-balance sheet asset holding of the third party that has purchased it outright as well as still being recorded on-balance sheet as a security asset holding of the original lender of the securities.³⁸

4.96. When a security acquired under a securities lending transaction has been on-sold, additional information may be required to understand securities lending activity and to determine who is holding the instrument. Accordingly, it is recommended that data on the counterparty (resident sector or nonresident) to the securities lending and the instrument and sector of issuer (e.g., government debt security) be provided to the compilers for ensuring appropriate recording in sectoral balance sheets, as explained in the above paragraph. In some instances, these data may prove difficult to obtain as it is possible that the owner of the security is unaware that the security is under a security lending arrangement. This is common as custodians often obtain blanket agreements from the securities’ owners to lend the securities without obtaining specific approval on each occasion. When this occurs, the owner may be unaware that a security has been “loaned.” Accordingly, it is recommended that when securities lending without cash collateral is significant, efforts should be made to obtain data on this activity from the custodians, to ensure accurate recording of debt securities at sectoral level.

³⁶ If the original owner does not retain these elements of ownership, the provision of the securities should be viewed as an outright sale.

³⁷ In some instances, collateral is not provided.

³⁸ The collateral might, conceivably, be provided in part in securities and the rest in cash. If so, the securities lending should be recorded as a loan in the amount of the cash collateral and, in all other respects, should not be recorded on the balance sheets of the lender and borrower of the securities.

Gold Swaps and Gold Loans

4.97. Gold swaps^{39 40} are forms of repurchase agreements undertaken between central banks or between a central bank and other types of financial institutions. They occur when gold is exchanged for foreign exchange, at a specified price with a commitment to repurchase the gold at a fixed price on a specified future date so that the original party remains exposed to the gold market. Its features are similar to those of a repo and, therefore, they should be treated in a similar way.

4.98. Gold swaps should be recorded as collateralized loans when they involve the exchange of gold for foreign exchange. Consequently, the gold remains on the balance sheet of the original owner and is not taken on to the balance sheet of the cash provider—in the same manner in which a repurchase agreement is recorded. If gold received under a gold swap is swapped again, the same treatment applies—it is treated as a collateralized loan by both parties. In the event that the gold received under a gold swap is sold outright, the seller (if not a monetary authority) should record a “short” holding of nonmonetary (i.e., commodity) gold and the purchaser (if not a monetary authority) should record on its balance sheet a holding of nonmonetary (i.e., commodity) gold. If the gold acquired under a gold swap is sold outright by a nonmonetary authority to a monetary authority, monetization will be involved.⁴¹ If gold received under a gold swap is sold outright by a monetary authority (whether to a monetary authority or another party), it should record on its balance sheet a negative position in monetary gold. The transaction will involve demonetization if the counterparty in this instance is not a monetary authority.

4.99. Gold loans (or gold deposits) may be undertaken to obtain an income return on gold. The gold that is placed on loan (or deposit) may be either a financial asset (i.e., monetary gold) or a nonfinancial asset (i.e., 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 (or deposits) 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* (and the *2008 SNA* and other statistical manuals) recommends that gold loans be treated as off-balance-sheet items (i.e., not recorded as transactions and assets or liabilities). 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. (See also paragraph 4.41 on allocated and unallocated gold accounts.)

³⁹ These swaps should not be confused with interest rate or currency swaps that are financial derivatives, as described later in this chapter.

⁴⁰ Gold swaps may be more broadly defined to include arrangements involving nonmonetary gold and parties other than qualified holders of monetary gold.

⁴¹ This could create the situation where monetary gold is overstated, in aggregate, as far as the same holding of gold would be reported on the balance sheet of two monetary authorities at the same time, if both the originator of the gold swap and the outright purchaser are monetary authorities, and the outright seller is not a monetary authority; there will be no offsetting negative position—the negative position will be recorded by the nonmonetary authority in nonmonetary gold.

4.100. Recording repos, securities lending, gold swaps and gold loans (reverse transactions) under the collateralized loan approach as set out in this *Manual*, is in line with the economic ownership principles in the *2008 SNA*.

Financial Leasing

4.101. A financial lease is a contract under which the lessor as legal owner of an asset passes the economic ownership of the asset to the lessee who accepts all the risks and receives the economic benefits from using the asset. The lessee, therefore, becomes the economic owner of the asset. Under a financial lease, the lessor is shown as making a loan to the lessee, which the lessee uses to acquire the asset. Thereafter, the leased asset is shown on the balance sheet of the lessee and not of the lessor, the corresponding loan is shown as an asset of the lessor and a liability of the lessee. The payments by the lessee to the lessor do not represent rentals on the asset, but payments of interest, possibly a service charge (financial intermediation services indirectly measured), and repayments of principal on the imputed loan. Such financial leases are classified as loans.

4.102. The statistical treatment of financial leases is designed to move away from the legal arrangements to capture the economic reality of such arrangements, by treating assets under a financial lease as if they were purchased and owned by the user which is financed with a loan. For example, if a bank leases a cargo vessel to a transportation company, the company is deemed to take economic ownership of the vessel. The vessel is therefore shown as an asset in the balance sheet of the transportation company, while a loan is recorded as a liability.

4.103. Examples of situations that would normally lead to a lease being classified as a financial lease include:

- (a) the lease transfers legal ownership to the lessee at the end of the lease term; or
- (b) the lease has the option for the lessee to acquire legal ownership at the end of the lease term at a price that is sufficiently low that the exercise of the option is reasonably certain; or
- (c) the lease term is for the major part of the economic life of the asset; or
- (d) at inception, the present value of the lease payments amount to substantially all of the value of the asset; or
- (e) if the lessee can cancel the lease, the lessor's losses are borne by the lessee; or
- (f) gains or losses in the residual value of the residual asset accrue to the lessee; or
- (g) the lessee has the ability to continue the lease for a secondary period for a payment substantially lower than market value.

4.104. These examples may not, however, demonstrate conclusively that all of the risks have been conveyed; for example, if the asset is conveyed to the lessee at the end of the lease at its fair value at that time, then the lessor holds substantial risks of ownership. Financial leases are

also called finance leases, capital leases, or full-payout leases, highlighting that the motivation is to finance acquisition of the asset. Accounting practices recognize financial leases in the same way.

Credit Card Debt

4.105. Credit cards are used as a convenient means of payment for purchases and as a means of financing purchases. Card holders normally do not incur financing charges if the entire balance due for their credit-card purchases is paid within each billing cycle, typically monthly. Card holders, 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. All credit card balances should be classified as loans, and payments such as interest or overdue fees are recorded as for loans.

Loan Participations

4.106. A loan participation occurs when two or more investors (usually FCs) 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.

4.107. 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 nonassignment 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:

- (a) 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 creditor. 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.
- (b) Nonassignment 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.

4.108. Loan participations that, after initial purchase, are to be held to maturity should continue to be classified as loans. If structured as a negotiable instrument, all syndicate

participations should classify the loan participations as debt securities, resulting in the single classification, as debt securities, for the entire syndicated loan. Collection and disbursement of the interest and principal payments are usually on a pass-through basis. The FC 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 negotiable are within the broad category of pass-through securities, and those arranged on a nonassignment basis are within the subcategory of asset-backed securities.

4.109. An FC may specialize in originating loans that are to be sold (usually, shortly after origination) to another FC that intends to hold the loans to maturity. It is recommended that these instruments be classified as loans.

Bills of Exchange and Acceptances

4.110. 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* and 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”—stamped⁴² and signed—by the party on whom it is written (i.e., the drawee), the bill of exchange becomes a promissory note⁴³ and is designated as an *acceptance*.⁴⁴

4.111. An acceptance is classified within loans, debt securities, or trade credit, depending on the characteristics of the credit instrument. Those acceptances that are eligible for rediscounting in a secondary market or by a central bank are usually known as bankers’ acceptances and classified as debt securities (see paragraph 4.56) and those ineligible for rediscounting are designated as other acceptances and are classified as loans or trade credit depending on the nature of the acceptance.⁴⁵ The loans and debt securities created through acceptances include:

- (a) 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 trade credit claim on the drawee.

⁴² Traditionally, a stamp and signature were required, but modern drafts may not be stamped.

⁴³ See 4.65 for the definition of promissory notes. The classification of acceptance is explained in the next paragraph.

⁴⁴ A 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.

⁴⁵ ODCs 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.

- (b) Export bill. Instead of holding the acceptance, the drawer (exporter) may rediscount the acceptance at a DC. If ineligible for further rediscounting, the acceptance should be classified as a loan that the DC has extended to the drawee (importer). If eligible for rediscount in the bankers' acceptances (BA) market and/or at the central bank, the acceptance should be classified within debt securities and, for purposes of sectoral classification, should be attributed to the economic sector of the drawee (importer), who is the original issuer. For example, the BA based on an export bill drawn on an importer should be classified within debt securities 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 DC should classify the BA within debt securities in the subcategory for claims on other DCs.
- (c) 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 ODC that will make the payment. The credit advanced to the importer is classified as a loan by the ODC. The loan remains in the DC's loan portfolio until repaid by the importer.
- (d) Own acceptances. A DC may repurchase its' own acceptances that it earlier issued in the BA market. Holdings of own acceptances, representing a DC's liability to itself, should be deducted from the liability account for BAs outstanding. The repurchased own BAs can be reintroduced as a debt security, if the DC decides to rediscount them in the BA market during the remaining term to maturity.

Nonperforming Loan (NPL)

4.112. *This Manual (and the 2008 SNA and other statistical manuals) defines a NPL as a loan on which payments of interest and/or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other reasons (such as a debtor filing for bankruptcy) to doubt that payments will be made in full.* Once a loan is classified as NPL, it (or any replacement loans) should remain classified as such until payments are received or the principal is written off on this or subsequent loans that replace the original.

4.113. Impaired loan trading. Loans sold in secondary markets range from high-quality loans (those with little credit risk) to nonperforming or otherwise impaired loans for which repayment is highly uncertain, or even unlikely. Transactions in nonperforming or otherwise impaired loans often involve purchases of portfolios of substandard loans at deep-discount prices (i.e., at well below the nominal value, or carrying amount, of the loans), reflecting the potential default on interest and principal payments for significant proportions of the loan portfolios purchased. These instruments should be classified as loans even if sold at a fraction of nominal value unless there is evidence of secondary market trading, including the existence of market makers, and frequent quotations of the instruments, such as provided by bid-offer spreads. In the later case, they are classified as debt securities and recorded at market value.

Distinction between Deposits and Loans

4.114. As a general principle, 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, etc). Classification as a loan is precluded from transferable deposits, because loans are not usable for third-party payments.

4.115. Differentiating between an other deposit (i.e., nontransferable deposit) and a loan can be more difficult. This *Manual* recommends that classification as an other deposit or as a loan is based on the instrument characteristics specified in the documentation, focusing on whether an early withdrawal for the creditor is possible or not. If the creditor does not have an option of early withdrawal, the instrument should be classified as a loan. 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).

4.116. Further guidance for distinguishing between other deposits and loans is provided below.

Other deposits

4.117. Deposits in broad money (see Chapter 6). The issue of distinguishing between a loan and a deposit does not arise for a financial instrument that is included in broad money. In particular, broad money does not include a separate component for loans. Any financial instrument that, in national terminology, is designated or informally described as a loan is classified as an *other deposit*, if the financial instrument is included in broad money.

4.118. 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 this Manual, loans are generally recognized as interest-bearing instruments (with some minor exceptions such as a credit card debt that is paid within the specified period). The most common category of zero-interest deposits are transferable deposits held by the money-holding sectors. Zero-interest deposits may also appear as deposit holdings of the central government (in the central bank or ODCs), non-interest-bearing reserve accounts that ODCs hold at the central bank, or non-interest-bearing transferable deposits that represent a DC's claim on, or liability to, another DC (including a non-resident DC).

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

4.120. Insured deposits. Deposit insurance is a means of ensuring that depositors (usually only households) will recover all or part of their deposit balances in DCs that have been liquidated. Credit guarantees which are applied to loans and debt securities are similar to deposit insurance. 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 usually provided by an institutional unit—the insuring agency—that specializes in insuring broad categories of DCs’ liabilities to households. In contrast, credit guarantees apply to an individual loan or loan portfolio (or specific set of securities). 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.

4.121. Deposits in the form of repurchase agreements. Overnight and short-term repurchase agreements are classified as other deposits if these are included in broad money (see also 4.87). All other repurchase agreements (and all collateral-based security lending arrangements) are classified as loans.

4.122. Margin deposits. Investors hold deposits to meet the daily settlement requirements for financial futures and for other purposes. Margin deposits held at DCs are 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*. The margin accounts are not classified as loans (see also 4.45–4.49).

4.123. 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 (1) reduce monthly loan payments; (2) occasionally skip monthly payments; or (3) 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. The deposit and loan components of the offset mortgage are recorded separately in the categories of *Deposits* and *Loans*, respectively.

Loans

4.124. 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.

4.125. 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).

4.126. Loans with supporting balance requirements. Loan contracts can 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. Similar requirements do not exist for deposits.

4.127. 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. Similar arrangements do not exist for deposits. Credit in the form of bankers' acceptances which are tradable instruments, should be classified as debt securities.

4.128. Loans made under commitment. Loan commitments, which once were informal credit lines available to corporate customers who kept adequate deposit balances at lending institutions, and are now 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.

Distinction between Loans and Debt Securities

4.129. The defining feature that distinguishes between loans and debt securities is that the former are nonnegotiable financial contracts (evidenced by nonnegotiable documents), whereas the latter are negotiable instruments.⁴⁶ Loans that become negotiable or tradable should be reclassified from loans to debt securities, but only if there is evidence of secondary market trading, including the existence of market makers, and frequent quotations of the instruments, such as provided by bid-offer spreads. In other words, debt securities should include loans that have become negotiable de facto. These debt securities result from the conversion of loans, with the recording of two OCVA flows, that is, liquidation of the loan and creation of the new debt security (see also paragraph 5.66e).

E. Equity and Investment Fund Shares

4.130. Equity and investment fund shares have the distinguishing features that the holders own a residual claim on the assets of the institutional unit that has issued the instrument.

⁴⁶ Similar to the case between loans and debt securities, the defining feature that distinguishes between deposits and debt securities is that the former are nonnegotiable financial contracts (evidenced by nonnegotiable documents), whereas the latter are negotiable instruments.

Equity

4.131. ***Equity comprises all instruments and records acknowledging claims on the residual value of a corporation or quasi-corporation after the claims of all creditors have been met.*** Equity is treated as a liability of the issuing institutional unit.

4.132. Ownership of equity in legal entities is usually evidenced by shares, stocks, participations, depository receipts or similar documents. Shares and stocks have the same meaning. Participating preferred shares are those that provide for participation in the residual value on the dissolution of an incorporated enterprise. Such shares are also equity securities, whether or not the income is fixed or determined according to a formula.

4.133. Equities are subdivided, in the *2008 SNA* (but not in this *Manual* for purposes of compiling monetary and financial statistics), into:

- (a) listed shares;
- (b) unlisted shares; and
- (c) other equity.

4.134. Both listed and unlisted shares are negotiable and are, therefore, equity securities.

4.135. Listed shares are equity securities listed on an exchange. They are also referred to as quoted shares. The existence of quoted prices of shares listed on an exchange means that current market prices are readily available.

4.136. Unlisted shares are equity securities not listed on an exchange. Unlisted shares can also be called *private equity*; venture capital usually takes this form. Unlisted shares tend to be issued by subsidiaries and smaller scale enterprises and typically have different regulatory requirements, but neither qualification is necessarily the case.

4.137. 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 traded on a securities exchange (listed shares), traded in an over the counter market or not traded.

4.138. Share holdings of FCs include shares of their own subsidiaries, as well as shares of unrelated corporations. Financial holding corporations (see paragraph 3.172) hold shares of subsidiaries (principally, FCs) that they own and control. Subject to national law and regulation, FCs may hold shares in DCs, OFCs, nonfinancial corporations, and foreign corporations. In a few countries, FCs (and, in some countries, other investors) hold central bank shares.

4.139. Corporations sometimes purchase their own shares in the market. The re-acquired shares (called treasury shares) are not classified as asset holdings (i.e., as an FC's claim on itself) but, rather are deducted from funds contributed by owners within the liability account for equity and investment fund shares.

4.140. Equity shares include depository receipts (DRs) (those that have shares as underlying instruments)—securities that evidence ownership of shares in foreign corporations—as well as directly owned shares of corporations. (See also paragraph 4.64.)

4.141. Other equity is equity that is not in the form of securities. It can include equity in quasi-corporations (such as branches, trusts, limited liability and other partnerships), unincorporated funds and notional units for ownership of real estate and other natural resources. The ownership of some international organizations is not in the form of shares and so is classified as other equity (although equity in the Bank for International Settlements (BIS) is in the form of unlisted shares). Ownership of currency union central banks is included in *other equity*.

4.142. Other equity is principally in the form of the accumulation of proprietor's net additions to the equity of quasi-corporate enterprises—such as, (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.

4.143. 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. Further, the owner may provide nonfinancial assets such as machinery, and this increases the value of other equity in the quasi-corporation to the owner.

Investment Fund Shares or Units

4.144. *This category includes shares or units of all kinds of investment funds, including MMFs and non-MMF investment funds described in Chapter 3* (see paragraphs 3.136–138 and 3.141–143). Exchange Traded Fund (ETF) shares are also included in investment fund shares. ETF is a fund—similar to a mutual fund—with a fixed share capital, in which investors entering or leaving the fund must buy or sell existing shares. An ETF tracks indices, such as for stocks, commodities, or bonds and is traded over the course of the trading day on an exchange.⁴⁷

Equity—liability account for monetary statistics

4.145. In the context of the monetary statistics discussed in Chapters 6 and 7 of this *Manual*, FCs' total liabilities in the form of equity (except MMF and non-MMF investment fund shares) are divided into the following separate components:

⁴⁷ iShares are a family of ETFs managed by the investment management company, BlackRock. iShares, Inc. funds began trading in the United States and the United Kingdom in 2000 and are listed on major exchanges.

- (a) 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;⁴⁸
- (b) Retained earnings constitute all previous years' after-tax profits that have not been distributed to shareholders or appropriated as general or special reserves;⁴⁹
- (c) Current year result represents the accumulation of the current profit or loss;
- (d) General and special reserves are appropriations of retained earnings;⁵⁰ and
- (e) Valuation adjustment shows the net counterpart to changes in the value of assets and liabilities on the balance sheets of FCs, excluding those changes in value (i.e., gains or losses) that are recorded in net profit or loss for the period under IFRS or national financial reporting standards. (See also Chapter 2, paragraph 2.52.)

4.146. Disaggregation of liability equity and investment fund shares into the above categories is a feature of monetary statistics and, although it does not appear as a standard classification of liability equity in the *2008 SNA*, it is consistent with the equity components under the valuation approach called *own funds at book value* (see *2008 SNA*, paragraph 13.71e). Data for these categories support the balance sheet identity in the sectoral balance sheets and provide the necessary details for the analysis of the structure of FCs' equity. The accounting rules for valuing these components are described in Chapter 5 of this *Manual*.

F. Insurance, Pension, and Standardized Guarantee Schemes

4.147. The category of insurance, pension, and standardized guarantee schemes (IPSGS) accounts for (1) specific types of liabilities issued by insurance corporations (and quasi-corporations), pension funds, or issuers of standardized guarantees, and (2) the corresponding assets of the policyholders or beneficiaries in the form of prepayments of insurance premiums, pension contributions, or fees for guarantee schemes that constitute claims on insurance corporations, pension funds, and issuers of standardized guarantees, respectively.

⁴⁸ Included are the shares of non-MMF investment funds. MMF shares are separately identified.

⁴⁹ 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 the reported data for the monetary statistics, retained earnings should include all profit or loss that has accumulated in previous periods and have been officially transferred to retained earnings; current year result should include the current period profit or loss that has not been officially transferred to retained earnings.

⁵⁰ In many cases, general reserves are required by law to provide the entity and its creditors with an added measure of protection from the effects of losses. Special reserves also provide added protection, but from the effects of losses that may arise from specific activities of the corporation or quasi-corporation.

4.148. This section deals mainly with the classification of respective asset and liability accounts of insurance corporations, pension funds, and standardized guarantee schemes included in the OFCs subsector, as reflected in the sectoral balance sheets in the monetary statistics. The accounts within this category receive separate treatment, owing to the specialized treatment of these accounts in national financial reporting standards and the macroeconomic statistics.

4.149. Insurance, pension, and standardized guarantee schemes are usually intermediated by FCs.⁵¹ There are five categories of reserves applicable to insurance, pension, and standardized guarantee schemes:

- (a) Nonlife insurance technical reserves;
- (b) Life insurance and annuities entitlements;
- (c) Pension entitlements;
- (d) Claims of pension funds on the pension manager;
- (e) Provisions for calls under standardized guarantees.

4.150. These reserves, entitlements, and provisions, except for claims of pension funds on the pension fund manager, represent liabilities of the insurer, pension fund, or issuer of standardized guarantees and a corresponding asset of the policyholders or beneficiaries. Only claims related to nonlife insurance technical reserves, claims of pension funds on the pension manager, and claims related to provisions for calls under standardized guarantees may appear as assets in the balance sheets of FCs.

4.151. The insurers, pension funds, and guarantors usually hold a range of assets to allow them to meet their obligations; however, these are not necessarily equal to the provision and entitlement liabilities. The aggregate value of liabilities can be estimated actuarially.

Nonlife Insurance Technical Reserves

4.152. Nonlife insurance provides cover to the policyholders against loss or damage suffered as a result of an accident. *Nonlife insurance technical reserves consist of reserves for unearned insurance premiums and reserves against outstanding insurance claims as discussed below and are pertinent to both nonlife direct insurance and reinsurance (see also paragraph 4.155):*

- (a) Reserves for unearned insurance premiums cover prepayment of net nonlife insurance premiums. A buyer of an insurance coverage (the “insurance policy”) pays for this service an amount—called a premium—to the insurance provider. The client prepays the

⁵¹ For definitions of insurance corporations, pension funds, and standard guaranteed corporations see Chapter 3, paragraphs 3.179-3.182, 3.184–3.190, and 3.183, respectively.

entire premium (the cost of the insurance policy for the entire period) at the beginning of the period of insurance coverage. The insurance provider earns income from the insurance service provided to the client on an accrual (“pro-rated”) basis.⁵² The category includes prepayments for nonlife insurance policies which cover a wide variety of events such as accident, sickness, fire, theft, etc. The category also includes less common types of premium payments, including those for reinsurance, deposit insurance,⁵³ 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 nonlife insurance corporation. It also includes reserves for unexpired risks. In the *2008 SNA* and this *Manual* methodology, term insurance is treated as a form of nonlife insurance. According to the *2008 SNA* (paragraph 17.6), a policy that provides a benefit in the case of death within a given period but in no other circumstances is usually called term insurance and should be regarded as non-life insurance because, as with other non-life insurance, a claim is payable only if a specified contingency occurs and not otherwise.

Prepayment of insurance premiums is one of the categories of *IPSGS* for which there are both asset and liability accounts in the sectoral balance sheets of FCs. The asset account covers the amount of FCs’ prepayments for insurance services to all resident and nonresident insurers; the liability account covers the prepayment of insurance premiums received from all resident and nonresident policyholders by a resident insurance corporation.

Prepayments in the asset account for *IPSGS* need to be disaggregated by prepayments made to resident (with breakdowns into ODC⁵⁴ and OFC) and nonresident insurers. The disaggregation is needed to facilitate the compilation of total claims on and liabilities to (1) resident individual institutional sectors and (2) nonresidents, as shown in the consolidated surveys compiled from the sectoral balance sheets discussed in Chapter 7.

- (b) Reserves against outstanding nonlife insurance claims are funds set aside by insurance corporations to cover the amounts that they expect to pay out in respect of valid claims that are not yet settled or claims that may be disputed. Reserves against such outstanding claims are considered to be assets of the beneficiaries and liabilities of the insurance corporations. Policy benefits due to claimants are considered assets of the

⁵² 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 is classified separately in insurance technical reserves, because of the specialized treatment of insurance corporations’ output in the national accounts statistics.

⁵³ Deposit insurance included in this category should be distinguished from deposit protection scheme, also known as deposit insurance provided to the general public. The former relates to deposit insurance policies at the initiation of the deposit holders who pay an insurance premium for the insurance service, whereas the latter relates to ODCs’ participation in deposit protection schemes, which is usually mandatory under national legislation and in which the participating ODCs pay fees or contributions to the scheme.

⁵⁴ ODCs may also engage in insurance business.

claimants. Until paid, these assets are held by insurance corporations as reserve liabilities.

Other reserves, such as equalization reserves, may be identified by insurers; these are recognized as liabilities and corresponding assets, only when there is an event that gives rise to a liability. Otherwise, equalization reserves are internal accounting entries by the insurer that represent saving (recorded under the general and special reserves component of equity) to cover irregular catastrophes and, thus, do not represent any existing corresponding claims for policyholders.

4.153. Investment income attributable to policyholders generated from the assets corresponding to nonlife insurance technical reserves 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.⁵⁵

Life Insurance and Annuity Entitlements

4.154. Life insurance and annuity entitlements are used to provide benefits to policyholders upon the expiry of the policy, or to compensate beneficiaries upon the death of policyholders, and, thus, are kept separate from shareholders' funds. Annuity entitlements are the actuarial calculation of the present value of the obligations to pay future income until the death of the beneficiaries. These entitlements show the extent of financial claims which policyholders have against an institution offering life insurance or providing annuities and are therefore regarded as liabilities of the life insurance corporations and annuity providers, and assets of the policyholders and beneficiaries. ***This category consists of reserves of life insurance corporations and annuity providers for prepaid premiums and accrued liabilities to life insurance policyholders and beneficiaries of annuities.***

Reinsurance

4.155. Reinsurance is insurance where both parties to the policy are providers of insurance services. That is, reinsurance allows insurance risk to be transferred from one insurer to another. Many insurers act as both direct insurers and reinsurers. There may be chains of transferring risk, from insurer to reinsurer to secondary reinsurer and so on. This *Manual* (and the *2008 SNA* and other statistical manuals) recommend that the transactions and positions between the direct insurer and the reinsurer should be recorded as a separate set of transactions and positions rather than on a net basis—that is no consolidation takes place between the transactions of the direct insurer as issuer of policies to its clients on the one hand and the holder of a policy with the reinsurer on the other and the claim of the original issuer of policies on the reinsurance corporation is not netted out from its liabilities to beneficiaries. Reinsurance activities are classified and recorded in the same way as direct nonlife insurance.

⁵⁵ For life insurance, the income earned by insurance corporations from their holdings of assets to meet their liabilities (which equal to the present value of expected claims from existing policyholders) is attributed to the policyholders as investment income on their claims on life insurance corporations.

Pension Entitlements

4.156. Pension entitlements are used to provide retirement benefits for specific groups of employees. *These entitlements show the extent of financial claims which both existing and future pensioners hold against either their employer or a fund designated by the employer to pay pensions earned as part of a compensation agreement between the employer and employee.* In addition to liabilities of pension funds, this category includes liabilities of unfunded pension schemes. As well as pensions, some schemes may have other related liabilities, such as for health benefits, which are included under entitlements to non-pension benefits. For pragmatic reasons, liabilities for non-pension entitlements may be included with those for pension entitlements.

4.157. Potential payments by social security schemes are not be recognized as financial assets or liabilities. However, if a social security fund also acts as a pension scheme (as is sometimes the case for benefits for present and former government employees), those pension obligations (but not implicit social security obligations) are included under this category.

Claims of Pension Funds on the Pension Manager

4.158. An employer may contract with a third party to administer the pension funds for his employees. If the employer continues to determine the terms of the pension schemes and to retain the responsibility for funding any deficit as well as the right to retain any excess funding, the employer is described as the *pension manager* and the unit working under the direction of the pension manger is described as the *pension administrator*. If the agreement between the employer and the third party is such that the employer passes the risks and responsibilities for any deficit in funding to the third party in return for the right of the third party to retain any excess, the third party becomes the pension manger as well as the administrator.

4.159. *When the pension manager is a unit different from the administrator, with the consequences that responsibility for any deficit or claims on any excess rests with the pension manager, the claim of the defined benefit pension fund on the pension manager is shown under this category.*

Provisions for Calls Under Standardized Guarantees

4.160. *Provisions for calls under standardized guarantees consist of prepayments of net fees and provisions to meet outstanding calls under standardized guarantees.*

4.161. Standardized guarantees are defined as those that are not provided by means of a financial derivative (i.e., credit default swaps) nor in the form of a one-off guarantee, but for which the probability of default can be well established. These guarantees cover similar types of credit risk for a large number of cases. Examples include guarantees issued by governments on export credit or student loans. It is not possible to estimate precisely the risk of any one loan being in default, but it is possible to make a reliable estimate of how many out of a large number of such loans will default. It is, therefore, possible for a guarantor to determine suitable fees to charge for a guarantee working on the same principle as an insurance corporation for which the fees received in respect of many policies cover the losses by a few.

The transactions and positions for provisions for calls under standardized guarantee schemes recorded in this *Manual* are similar to reserves for nonlife insurance; they include unearned fees and calls not yet settled.

4.162. Standardized guarantees can be contrasted with two other types of guarantees:

- (a) Guarantees that meet the definition of financial derivatives (as defined in paragraph 4.164) protect the lender, on a guarantee-by-guarantee basis, against certain types of risk arising from a credit relationship by paying the guarantor a fee for a specified period. The guarantees covered are such that experience in the market allows the guarantor to apply standard master legal agreements or to make a reasonable estimate of the likelihood of the borrower defaulting and to calculate suitable terms for the financial derivative. Credit default swaps are included in financial derivatives as options (see paragraphs 4.188 and 4.190).
- (b) One-off guarantees occur in situations in which the conditions of the loan or of the security that is guaranteed are so particular that it is not possible for the degree of risk associated with it to be calculated with any degree of precision. These guarantees are not recognized as economic assets until their activation, that is, when the event occurs that makes the guarantor responsible for the liability. These are off-balance sheet contingent assets until activated.⁵⁶

G. Financial Derivatives and Employee Stock Options

4.163. Financial derivatives and employee stock options are financial assets and liabilities that have similar features, such as a strike price and some of the same risk elements. Although both transfer risk, employee stock options are also designed to be a form of remuneration.

Financial Derivatives

4.164. *A financial derivatives contract is a financial instrument that is linked to another specific financial instrument, indicator, or commodity, and through which specific financial risks (e.g., interest rate risk, foreign exchange risk, equity and commodity price risk, credit risk) can be traded in their own right in financial markets.* The value of a financial derivative derives from the price of an underlying item: the reference price. The reference price may relate to a commodity, a financial asset, an interest rate, an exchange rate, another derivative or a spread between two prices. The derivative contract may also refer to an index or a basket of prices. No principal amount is advanced that has to be repaid, and no investment income accrues. Financial derivatives are used for a number of purposes, including risk management, hedging, arbitrage between markets, and speculation. Valuation of financial derivatives is covered in Chapter 5.

⁵⁶ One-off guarantees granted by governments to corporations in financial distress and that have a very high likelihood of being called are, however, treated as if they were activated at inception.

4.165. The risk embodied in a financial derivative contract can be traded either by trading the contract itself, as is possible with options, or by creating a new contract embodying risk characteristics that match, in a countervailing manner, those of the existing contract. The latter practice, which is termed *offsetability*, occurs in forward markets. Offsetability means that it is often possible to eliminate the risk associated with a derivative by creating a new but “reverse” contract having characteristics that countervail the risk underlying the first derivative. Buying the new derivative is the functional equivalent of selling the first derivative because the result is the elimination of the underlying financial risk. The ability to countervail the underlying risk in the market is therefore considered the equivalent of tradability in demonstrating value. The outlay that would be required to replace the existing derivative contract represents its value; actual offsetting is not required.

4.166. Financial derivative contracts are usually settled by net payments of cash rather than by the delivery of the underlying items. Exchange-traded contracts, such as commodity futures, are often settled before maturity. Cash settlement is a logical consequence of the use of financial derivatives to trade risks independently of the ownership of underlying items. Some financial derivative contracts, particularly those involving foreign currency, are, however, settled by deliveries of the underlying items. Once a financial derivative reaches its settlement date, any unpaid overdue amount is reclassified as accounts receivable/payable, as its value is fixed, and, thus, the nature of the claim becomes debt.

4.167. The classification of margins required for financial derivatives depends on whether they are repayable or non-repayable. The classification principles are discussed in paragraphs 4.45–4.49.

4.168. For monetary and financial statistics purposes, the following types of financial instruments are not financial derivatives:

- (a) A fixed-price contract for goods and services is not a financial derivative unless the contract is standardized so that the market risk therein can be traded in financial markets in its own right.
- (b) Insurance is not a financial derivative. Insurance contracts provide individual institutional units with financial protection against the consequences of the occurrence of specified events. (In many instances, the value of this financial protection cannot be expressed in terms of market prices.) Insurance is a form of financial intermediation through which funds are collected from policyholders and invested in financial or other assets. These assets are held as technical reserves to meet future claims arising from the occurrence of events specified in insurance policies (i.e., insurance is used to manage event risk, primarily by the pooling, not the trading, of risk).
- (c) Contingencies, such as guarantees and letters of credit, are not financial derivatives. The principal characteristic of a contingency is that one or more conditions must be fulfilled before a financial transaction takes place. Contingencies are not instruments that facilitate the trading of specific financial risks.

- (d) 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. (See also paragraph 4.58.) 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 well differ from the values of comparable securities and loans because of the embedded derivative. Examples are bonds that are convertible into shares and securities with options for repayment of principal in currencies that differ from those in which the securities were issued.
- (e) Central bank swap arrangements and other similar arrangements that do not meet the definition of financial derivatives. (See *BPM6*, paragraphs 5.91 and 6.102–104.)

4.169. In addition, timing delays that arise in the normal course of business and that may entail exposure to price movements do not, for monetary and financial statistics purposes, give rise to transactions and positions in financial derivatives. Timing delays include normal settlement periods for spot transactions in financial markets.

4.170. There are two broad types of financial derivatives—options and forward-type contracts. A major difference between option and forward contracts is that, whereas either party to a forward contract is a potential debtor, the buyer of an option contract acquires an asset and the option writer incurs a liability. Option contracts can expire without worth; options are exercised only if settling a contract is advantageous for the option holder.

4.171. In the financial markets there are a large assortment of financial derivatives in the broad categories of forward-type contracts and options contracts. A number of standard types of forward-type contracts and options contracts are shown in Table 4.4 and Table 4.5, respectively. Examples of *exotic options*—those with relatively atypical contract terms—are described in Table 4.6.

Forward-type contracts

4.172. ***A forward-type contract (forward) is an unconditional contract by which two counterparties agree to exchange a specified quantity of an underlying item (financial or real) at an agreed-upon contract price (the strike price) on a specified date.*** Forward-type contracts include forwards, futures, and swaps.⁵⁷ Forward-type contract is used as a term because the term “forward” is often used more narrowly in financial markets (often excluding swaps).

⁵⁷ Except those swaps not meeting the definition of financial derivatives.

Table 4.4. Standard Types of Forward and Futures Contracts	
Definitions	Underlying instrument (Main price-settlement variable)
<p><u>Forward contract.</u> An over-the-counter agreement to buy or sell an asset for a predetermined delivery price at a specified future time.</p> <p><u>Futures contract.</u> An exchange-traded agreement to buy or sell an asset for a predetermined delivery price at a specified future time.</p>	<p>Future and/or forward contracts:</p> <ul style="list-style-type: none"> • Currency (exchange rate) • Equity shares in a corporation(s) (individual share price or stock price index) • Debt securities (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.
<p><u>Swap contract.</u> An over-the-counter agreement between two parties to exchange future cash flows.</p> <ul style="list-style-type: none"> • <u>Interest-rate swap.</u> Fixed-rate payments swapped for floating-rate payments. • <u>Currency swap.</u> Payments in one currency swapped for payments in another currency. • <u>Cross-currency interest-rate swaps.</u> Fixed-rate payments in one currency swapped for floating-rate payments in another currency. • <u>Equity swap.</u> 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. • <u>Forward rate agreement (FRA).</u> An over-the-counter obligation that applies a predetermined interest rate to a notional principal amount over a specified future time period. 	<ul style="list-style-type: none"> • Notional principal (interest rate) • Notional principal (exchange rate) • Notional principal (interest rate and exchange rate) • Notional principal (stock prices, stock price and interest rate, etc.) • Notional principal (interest rate)

4.173. At the inception of a forward-type contract, risk exposures of equal market value are exchanged, so a contract typically has zero value at inception. As the price of the underlying item changes, the market value will change, although it may be restored to zero by periodic

settlement during the life of the forward. The classification of a forward-type contract may change between asset and liability positions.

4.174. Futures are forward-type contracts traded on organized exchanges. The exchange facilitates trading by determining the standardized terms and conditions of the contract, acting as the counterparty to all trades, and requiring margin to be deposited and paid to mitigate against risk. Forward rate agreements and forward foreign exchange contracts are common types of forward-type contracts.

4.175. A forward rate agreement (FRA) is an arrangement in which two parties, in order to protect themselves against interest rate changes, agree on an interest rate to be paid, at a specified settlement date, on a notional amount of principal that is never exchanged. FRAs are settled by net cash payments. The only payment that takes place is related to the difference between the agreed forward rate and the prevailing market rate at the time of settlement. The buyer of the FRA receives payment from the seller if the prevailing rate exceeds the agreed rate; the seller receives payment if the prevailing rate is lower than the agreed rate. An FRA is equivalent to a swap agreement in which a pre-determined fixed-rate payment is swapped for a floating-rate payment.

4.176. A foreign currency forward contract involves two counterparties who agree to transact in foreign currencies at an agreed exchange rate in a specified amount at some agreed future date.

4.177. A swap contract involves the counterparties exchanging, in accordance with prearranged terms, cash flows based on the reference prices of the underlying items.⁵⁸ Swap contracts classified as forward-type contracts include currency swaps, interest rate swaps, cross-currency interest rate swaps, and equity swaps. Under a swap contract, the obligations of each party may arise at different times, for example, an interest rate swap for which payments are quarterly for one party and annual for the other. In such cases, the quarterly amounts payable by one party prior to payment of the annual amount payable by the other party are recorded as transactions in the financial derivative contract.

4.178. An interest rate swap contract involves an exchange of cash flows related to interest payments, or receipts, on a notional amount of principal, which is never exchanged, in one currency over a period of time. One party pays an interest rate based on variable rates and the other based on fixed rates. Settlements are often made through net cash payments by one counterparty to the other.

4.179. A foreign currency swap is a spot sale/purchase of currencies and a simultaneous forward purchase/sale of the same currencies.

4.180. For foreign currency swaps, it is necessary to distinguish between a transaction in a financial derivative contract and transactions in the underlying currencies. At inception, the

⁵⁸ Other types of arrangements also called swaps, but not meeting the definition above include gold swaps, central bank swap arrangements and other similar arrangements, and credit default swaps.

parties exchange the underlying currencies at prevailing market exchange rates. At the time of settlement, the difference in the values of the currency amounts swapped stemming from the difference between the agreed and the prevailing exchange rate is allocated to a transaction in a financial derivative. The underlying currencies swapped (usually through deposit accounts) are valued at the prevailing market exchange rate at the time of the settlement and are recorded as transactions in the underlying currencies (usually deposits).

4.181. A cross-currency interest rate swap, sometimes known as a currency swap, involves an exchange of cash flows related to interest payments and an exchange of principal amounts at an agreed exchange rate at the end of the contract.

4.182. An equity swap involves an exchange of cash flows based on the performance of a stock price or stock index for one party, and based on a fixed or floating rate, another stock price, or a stock index for the other party.

4.183. An off-market swap has a nonzero value at inception as a result of having reference rates priced differently from current market values (i.e., “off-the-market”). The economic nature of an off-market swap is equivalent to a combination of a loan and an on-market financial derivative.⁵⁹ Therefore, off-market swaps should be recorded as two stock positions in the sectoral balance sheets—a loan and an on-market financial derivative. In those cases where a swap does not have the characteristics of a financial derivative, such as a central bank swap arrangement or other similar arrangement, it should be treated as an exchange of deposits.

Options

4.184. ***In an option contract (option), the purchaser acquires from the seller a right to buy or sell, depending on whether the option is a call (buy) or a put (sell) a specified underlying item at a strike price on or before a specified date. The purchaser of an option pays a premium to the writer of the option.*** (On a derivatives exchange, the exchange may act as the counterparty to each contract.)

4.185. Options can be contrasted with forward-type contracts in that:

- (a) at inception, a premium is paid for an option representing a nonzero value for the contract, unlike a forward-type contract where there is usually no up-front payment and the derivative contract begins with a zero value;
- (b) during the life of the contract, for an option, the buyer is always the creditor and the writer is always the debtor, whereas for a forward-type contract, either party can be creditor or debtor, and it may change; and
- (c) at maturity, redemption is determined by the buyer of the option whereas it is unconditional for a forward-type contract.

⁵⁹ See also the *Public Sector Debt Statistics Guide for Compilers and Users*, paragraphs 3.44 and 4.128–131.

Definitions	Option contract
<p><u>Call and put options:</u></p> <ul style="list-style-type: none"> • <u>Call option.</u> 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. • <u>Put option.</u> 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. <p><u>American and European options:</u></p> <ul style="list-style-type: none"> • 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. <p><u>Bermuda option:</u></p> <ul style="list-style-type: none"> • A combination of American and European options. Exercisable at the date of expiration and on certain specified dates that occur between the purchase date and the date of expiration. <p><u>In-the-money and out-of-the-money options:</u></p> <ul style="list-style-type: none"> • In-the-money call (put) option. Strike price below (above) the market price of the underlying asset. • Out-of-the-money call (put) option. Strike price above (below) the market price of the underlying asset. 	<p>Option contract (strike price variable):</p> <ul style="list-style-type: none"> • <u>Stock option</u>¹ (market price of a corporation's equity shares) • <u>Index option</u> (level of a stock price index) • <u>Bond option</u> (market price of corporate or government securities) • <u>Foreign-currency option</u> (market exchange rate) • <u>Option on a futures contract</u>, called a futures option (market price of futures contract) • <u>Option on an interest-rate swap contract</u>—also called a swap option, or swaption (fixed interest-rate in the swap contract; strike price can also be stated in terms of the amount of notional principal)
<p>¹ Includes long-term equity anticipation securities (LEAPS).</p>	

4.186. Warrants are a form of financial derivative option giving the owner the right but not the obligation to purchase from the issuer of the warrant a fixed amount of an underlying asset, such as shares and bonds, at an agreed contract price for a specified period of time or on a specified date. Although similar to other traded options, a distinguishing factor is that the exercise of the warrants can create new securities, thus diluting the capital of existing bond or shareholders, whereas traded options typically grant rights over assets that are already available.

4.187. Warrants also include covered warrants that can have a wider variety of underlying financial instruments, and are issued by FCs. Covered warrants allow a holder to buy financial instruments issued by other institutional units and not only those instruments issued by the issuer of the warrant.

Table 4.6. “Exotic” Options Contracts: Examples¹

Definitions
<p><u>Nonstandard American options²</u></p> <ul style="list-style-type: none"> • 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. <p><u>Forward start option:</u> An option that starts at some future date.³</p> <p><u>Compound option:</u> 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).</p> <p><u>Chooser option</u> (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.</p> <p><u>Barrier option:</u> 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).</p> <p><u>Binary option:</u> 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).</p> <p><u>Lookback option:</u> An option for which the payoff depends on the maximum or minimum price of the asset during the life of the option.</p> <p><u>Asian option:</u> 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.</p>
<p>¹ Characteristics of these and other exotic options, along with valuation methods, are covered in Options, Futures, and Other Derivatives (2011) by John Hull.</p> <p>² Some warrants issued by corporations on their own stock have these features.</p> <p>³ Executive stock options often have this feature; right of exercise starts when the options are vested.</p>

Credit derivatives

4.188. ***Credit derivatives are financial derivatives whose primary purpose is to trade credit risk.*** They are designed for trading mainly in loan and security default risk. In contrast, the financial derivatives described in the previous paragraphs are related mainly to market risk of changes in the market prices of securities, commodities, interest and exchange rates. Credit derivatives take the form of both forward-type (total return swaps) and option-type contracts (credit default swaps).

4.189. A total return swap transfers both the credit and market risk of an underlying asset, such as a loan or a bond. Under a total return swap agreement, one party makes payments based on a set rate (fee), either fixed or variable, while the other party makes payments based on the return of an underlying asset, which includes both the income it generates and any capital gains. In this way, total return swaps allow the party receiving the total return to gain exposure and benefit from an underlying asset without actually having to own it, and allow the other party (which retains the underlying asset on its balance sheet) to buy protection against loss in its value.

4.190. In a credit default swap (CDS), the buyer of the swap pays a periodic fee to the seller of the swap in return for a cash payment by the seller in the event of a default by the debtor of

the underlying instrument. A CDS is also referred to as a credit derivative contract and is considered insurance against non-payment. A buyer of a CDS might be speculating on the possibility that the third party will indeed default.

4.191. Similar to other financial derivatives, credit derivatives are frequently drawn up under standard master legal agreements and involve collateral and margining procedures which allow for a means to make a market valuation.

Employee Stock Options

4.192. An employee stock option is an agreement made on a given date (the “grant” date) under which an employee may purchase a given number of employer’s shares at a stated price (the “strike” price), either at a stated date (the “vesting” date) or within a period of time (the “exercise” period) immediately following the vesting date. The exercise date is the time at which the option is exercised. It cannot be earlier than the vesting date or later than the end of the exercise period.

4.193. Employee stock options are issued as a form of employee compensation and as incentives for corporate employees to perform their duties in the best interests of the corporation’s shareholders. Transactions in employee stock options are recorded in the financial account as the counterpart to the element of compensation of employees represented by the value of the stock option. For many corporations, employee stock options are called executive stock options, because they are provided only to senior managers of the corporation. In some cases, stock options may be provided to suppliers of goods and services to the enterprise. Although these are not employees of the enterprise, for convenience they are also recorded under employee stock options because their nature and motivation is similar. Whereas the corresponding entry for stock options granted to employees is compensation of employees, the corresponding entry for stock options granted to suppliers is the goods and services supplied.

4.194. Employee stock options are similar to other long-term call options (long-term equity anticipation securities—LEAPS⁶⁰—of up to 3-year maturity). In other respects, executive stock options are similar to warrants that corporations issue on their own shares. The recipient of employee stock options may have the right to exercise a vested stock option at 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 through (1) issuing new shares; (2) drawing on own shareholdings (i.e., treasury stock); or (3) purchasing its own shares in the stock market for delivery to the option holder.

4.195. This *Manual* recommends the compilation of separate data on employee stock options consistent with the 2008 SNA subcategories of financial derivatives. The data on employee

⁶⁰ Publicly-traded options contracts with expiration dates that are longer than one year.

stock options should be available to compilers of the monetary and financial statistics, either on request or as a memorandum item in the standard format for data reporting.

H. Other Accounts Receivable/Payable

4.196. Other accounts receivable/payable include: (1) trade credit and advances, and (2) other.

Trade Credit and Advances

4.197. *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.* They consist of (1) credit extended directly by the suppliers of goods and services to their customers,⁶¹ and (2) advances for work that is in progress (or is yet to be undertaken) and prepayment by customers for goods and services not yet provided. For FCs, trade-credit receivables usually are associated with their sale of financial services, given that FCs seldom are vendors of goods and nonfinancial services. Trade-credit payables of FCs arise from their acquisition of goods and services provided by nonfinancial corporations, as well as from their purchases of financial services from other FCs.

4.198. 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 economic 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 *Other accounts receivable–other*. The provider of the future payment records the obligation in *Other accounts payable–other*.
- 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 under the category of IPSGS, rather than as trade credit, is an element of the *2008 SNA* and the methodology of this *Manual* that facilitates the data compilation for the insurance corporation subsector.

4.199. Trade credits do not include loans to finance trade credit. This *Manual* distinguishes between trade credits and loans by specifying that trade credits are direct extension of credit by the suppliers of goods and services to their customers, whereas financing provided by third parties to finance trade are classified as loans. In general, trade credits are not interest-bearing. They may have payment terms whereby cash discounts are provided for prompt payment. The cash discount is viewed as a subsequent reduction in the sale price of the good or service, rather than as implicit interest that is avoided by early payment, and so is recorded as a valuation change (See also paragraph 5.209).

⁶¹ Trade credit is sometimes described as supplier credit or supplier's credit.

Other accounts receivable/payable–other

4.200. 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.

4.201. Other accounts receivable–other should be disaggregated into resident and nonresident categories and should cover the following items (not identified separately, unless noted otherwise):

- (a) Dividends receivable on corporations' shares, arising from the recording of dividends when the shares go ex-dividend (the date dividends are excluded from the market price of shares), rather than when the dividends are paid. When notified that a share has gone ex-dividend, the shareholder records the amount of the dividend receivable.
- (b) Settlement accounts that 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.
- (c) Items in the process of collection are created when a DC 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 *Other accounts receivable–other*. The entry is reversed after the item has been presented through the clearing system and has been paid by the DC (resident or nonresident) on which it was drawn. The posting *Other accounts receivable–other* is needed unless the item is settled on the same day as deposited,⁶² or has been recorded on an off-balance-sheet basis.⁶³

A special category of *items in the process of collection* arises if a central bank provides advance availability of funds to ODCs that have sent checks or other items to the central bank for collection, known as *central bank float*. 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 DC 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. Central bank float is 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 *Manual*. (See also paragraphs 7.25 and 7.54d.)

⁶² For example, the item may have been written on the DC that received it, because the payee and payer are customers of the same DC. The propensity for same-day settlement increases as countries adopt electronic clearing of collectible items.

⁶³ Recording *items in the process of collection* off-balance-sheet may be a general practice in a few countries.

- (d) IMF quota subscription is recorded as an asset on the balance sheet of the central bank of the member country if the central bank has been designated as a depository and fiscal agency for the country's financial relationship with the IMF and records the *IMF quota subscription* and the *IMF No. 1 and debt securities accounts* on a gross basis⁶⁴ (see Annex 4.1). 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.
- (e) Miscellaneous asset items are all accounts not elsewhere classified in the FCs' balance sheets and include suspense accounts⁶⁵ (used for temporary recording of claims for which proper classification has not yet been determined, claims for which verifications, notifications, instructions, or other documentations are required for completing the transactions, and claims that are under litigation or otherwise in dispute) and prepayments of taxes, import duties, rent, wages, or other operating expenses.

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 *Manual*.

4.202. In exceptional circumstances, a relatively large transaction may be recorded in *Other accounts receivable–other*. If so, the FC should provide supplementary information to the compilers 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), for ensuring appropriate recording in the sectoral balance sheet.

4.203. *Other accounts payable–other* should be disaggregated into resident and nonresident categories, and provisions for losses on assets. Resident and nonresident categories should cover the following items (not identified separately):

- (a) Dividends payable that arise from the recording of dividends on the FC's shares at the time when the shares go ex-dividend, rather than when paid.
- (b) Settlements accounts that record an FC's obligations for payments (on future settlement dates) for financial assets that were purchased (on trade dates).
- (c) Miscellaneous liability items include suspense accounts (the same as for assets discussed in paragraph 4.201e) and accrued wages, rent, other operating expenses or taxes.

4.204. Provisions for losses on assets are recorded as a separate component in *Other accounts payable–other*. This accounting treatment contrasts with the *2008 SNA* in which such

⁶⁴ Alternatively, if net recording is exercised, the resulting *Reserve tranche position in the IMF* is recorded under *Other deposits* in foreign currency with nonresidents in the sectoral balance sheet of the central bank. (The *2008 SNA* and *BPM6* also recommend reporting of the *Reserve tranche position in the IMF*, as an *other deposit*.)

⁶⁵ It is recommended that an FC clear the items from the suspense accounts as soon as possible.

provisions are not recorded in the balance sheet. To be used in financial statistics, the data from the monetary statistics need to be adjusted to exclude provisions from *Other accounts payable–other*, in accordance with the methodology of the *2008 SNA*.

4.205. The balance-sheet presentation in 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 losses on assets. For monetary statistics, provisions for losses on assets are classified as *Other accounts payable–other*. Treatment of these items as liabilities facilitates the presentation of financial assets (and nonfinancial assets, if desired) on a gross basis. It preserves a full set of balance-sheet accounts without a deduction of these items from the asset accounts on the balance sheet, but differs from the *2008 SNA*, which does not regard such internal accounts as liabilities.

IV. CROSS-CLASSIFICATION OF FINANCIAL ASSETS BY SECTOR AND CURRENCY

4.206. In addition to the classification of financial assets and liabilities by type of instrument as discussed in the previous section of this chapter, the framework for compiling monetary and financial statistics calls for further cross-classification, at a minimum, by residency of the counterparties and institutional sector of resident counterparts, and by currency of denomination. For the central bank sectoral balance sheet, there is a need to identify separately those foreign assets that meet the definition of reserve assets as defined in *BPM6* (see paragraph 6.64) and are included in the *reserve assets* subcategory.

A. Cross-Classification by Institutional Sector of Counterparties

4.207. Monetary statistics focus on the flow and stock data on financial assets and liabilities of the FCs sector vis-à-vis the other resident institutional sectors and the rest of the world. Chapter 3 deals with institutional units in their role as holders or issuers of financial assets and focuses consequently on the classification and sectoring of their accounts in the financial system. The residency of institutional units determines the foreign/domestic breakdown of assets and liabilities of the FCs sector. Similarly, the grouping of resident institutional units into institutional sectors and subsectors allows presenting the FCs' claims on and liabilities to the different sectors of the domestic economy. The recommended analytical framework for compiling monetary statistics and financial statistics (Chapters 7 and 8, respectively) requires for each asset category a breakdown by institutional sector and subsector of counterparties, where applicable, in accordance with the sectoring principles discussed in Chapter 3.

4.208. For countries where the FCs sector has significant exposure to nonresidents, it is useful to identify broad institutional sectors of nonresident counterparties, for example, FCs and nonfinancial sector which may be further divided into general government sector and nongovernment sectors.⁶⁶ A breakdown of nonresident counterparties into financial and nonfinancial corporations for selected financial instruments is included as a memorandum item in the sectoral balance sheets/SRFs (see Appendix II).

⁶⁶ Interbank positions with nonresident affiliates are included in memorandum items in the sectoral balance sheets.

B. Cross-Classification by Currency of Denomination

4.209. The breakdown of assets and liabilities in the sectoral balance sheets of FCs between those denominated in foreign currency and those in domestic currency is relevant for understanding the growth in money and credit aggregates and vulnerabilities to movements in exchange rates. So for all financial assets and liabilities it is recommended to provide a cross-classification into domestic currency denomination and foreign currency denomination.⁶⁷

4.210. For some analysis, it may also be useful to have separate identification of major foreign currencies. For example, in *BPM6*, reserve assets are recommended to be further identified as held in currencies in the SDR basket and those not in the SDR basket.

4.211. Domestic currency is the one that is legal tender in the economy and is issued by the monetary authorities of that economy or of the common currency area to which the economy belongs. Any currencies that do not meet this definition are foreign currencies to that economy. Under this definition, an economy that uses as its legal tender a currency issued by a monetary authority of another economy—such as, U.S. dollars—or of a currency area to which it does not belong should classify the currency as a foreign currency even though domestic transactions are settled in it.

4.212. The currency composition of assets and liabilities is determined primarily by characteristics of currency denomination. Foreign currency instruments are those denominated in a currency other than the domestic currency. Foreign-currency-linked instruments are those payable in domestic currency but with the amounts to be paid linked to a foreign currency and, therefore, are considered to be denominated in foreign currency. Domestic currency instruments are those denominated in the domestic currency and not linked to a foreign currency. Domestic-currency-linked instruments are those payable in a foreign currency but with the amounts to be paid linked to a domestic currency. For monetary statistics purposes, domestic-currency-linked instruments are classified, by convention, as denominated in foreign currency. This treatment reflects the recognition that domestic-currency-linked instruments have exposure to the availability of foreign exchange for making the payment in foreign currency. In the unusual instance of debt instruments with interest payments to be paid in a foreign currency, but principal payments to be paid in a domestic currency, or vice versa, only the present value of the payments to be paid in a foreign currency should be classified as a foreign currency instrument.

4.213. A special case arises where an economy uses as its only legal tender a currency issued by a monetary authority of another economy (e.g., U.S. dollar) or of a common currency area to which the economy does not belong (e.g., euro). While this currency is classified as a foreign currency, it has some of the attributes of a domestic currency, because domestic transactions are settled in this currency. For these dollarized economies (discussed also in Chapter 6), in monetary statistics the unit of the foreign currency used as legal tender in the

⁶⁷ Deposits (except unallocated gold accounts with nonresidents that give title to claims on the delivery of gold), loans, and debt securities denominated in gold are treated as financial assets denominated in foreign currencies in the appropriate asset category.

economy is classified as the domestic currency unit of account for compiling sectoral balance sheets. In the sectoral balance sheets of FCs subsectors in these countries, the distinction is made for all financial assets and liabilities with resident counterparts (where applicable) between those in domestic currency unit (i.e., the foreign currency used as legal tender in the economy) and foreign currencies other than the legal tender. Thus, in this *Manual*, foreign currency which is a legal tender in an economy is included under domestic currency category for all domestic positions.⁶⁸

C. Cross-Classification of Monetary Liabilities

4.214. Deposits (both transferable and other) and debt securities on the liability side of the sectoral balance sheets of the central bank and ODCs are also cross-classified by their inclusion in or exclusion from monetary base⁶⁹ (only for the central bank sectoral balance sheet/SRF) and broad money.⁷⁰ These cross-classifications are necessary to support the compilation of the monetary base and the broad money in the respective analytical surveys, as discussed in Chapters 6 and 7.

V. SUPPLEMENTARY CLASSIFICATION OF FINANCIAL ASSETS

4.215. Even though the cross-classification of financial assets and liabilities by type, counterparty, and currency of denomination in the sectoral balance sheets provides the complete set of data necessary for the compilation of surveys and financial accounts, in some countries more disaggregated categories of the DC's liabilities may be needed to provide data for monetary aggregates that are more narrowly defined than in this *Manual*. Additional breakdowns of data are also needed for macroeconomic and financial stability analysis. This section discusses examples of supplementary classification of financial assets by maturity, type of interest rates, and other.

A. Classification by Maturity

4.216. Maturity is relevant for financial vulnerability analysis; both from a liquidity viewpoint (e.g., in estimating the value of liabilities falling due in the short term) and from an asset/liability mismatch perspective (e.g., in estimating the effect of changes in interest rates on profitability). For supplementary classification of financial assets,⁷¹ the maturity of a debt instrument is classified as short-term or long-term in this *Manual* as follows:

⁶⁸ This approach is reconcilable with *BPM6* and *External Debt Statistics Guide for Compilers and Users (2013)*; both classify the “legal tender foreign currency” as a foreign currency and recommend separate identification of the “legal tender foreign currency” from other foreign currencies in presenting data.

⁶⁹ Monetary base is defined in Chapter 6 of this *Manual* (Section IV) and is relevant to the central bank sectoral balance sheet only.

⁷⁰ Broad money is defined in Chapter 6 of this *Manual* (Section II) and is relevant to both the central bank and ODCs sectoral balance sheets.

⁷¹ This is in addition to identifying separate categories for debt securities and loans with a maturity of one year or less in the memorandum items to the sectoral balance sheets/SRFs.

- (a) *Short-term* is defined as payable on demand or with a maturity of one year or less. (Payable on demand refers to a decision by the creditor; an instrument where the debtor can repay at any time may be short- or long-term.)
- (b) *Long-term* is defined as having a maturity of more than one year or with no stated maturity (other than on demand, which is included in short-term).

4.217. Maturity may relate to:

- (a) original maturity (i.e., the period from issue until the final contractually scheduled payment); or
- (b) remaining maturity (i.e., the period from the reference date until the final contractually scheduled payment). This is also called residual maturity.

4.218. Currency is included in short-term maturity. Because of the nature of the relationship between the parties, when the maturity is unknown, all intercompany lending (as defined in *BPM6*, paragraph 6.26) may be classified as of long-term maturity, by convention. Insurance reserves, pension entitlements, and standardized guarantee provisions can potentially be classified by maturity; if data are not available, a convention can be adopted that they are all long-term. When securities contain an embedded option with a date on which or after which the debt can be put (sold) back to the debtor by the creditor, the maturity is determined without reference to these embedded put options. Financial derivatives could also be classified according to maturity.

B. Classification by Type of Interest Rate

4.219. Debt instruments may be classified as either *variable-rate* or *fixed-rate*. This breakdown may be useful for some analysis, in that variable-rate instruments are subject to fluctuation in income flows in response to changes in market conditions; fixed-rate securities are more subject to changes in prices.

4.220. Variable-rate debt instruments are those for which interest is linked to a reference index—for example, LIBOR (London interbank offered rate), or the price of a specific commodity, or the price of a specific financial instrument that normally changes over time in a continuous manner in response to market conditions. All other debt instruments should be classified as fixed-rate. An interest rate that is adjusted, but only at intervals of more than a year, is considered to be fixed. Interest that is adjusted each year or less is considered to be variable.

4.221. Interest on debt that is linked to the credit rating of another borrower should be classified as fixed-rate, because credit ratings do not change in a continuous manner in response to market conditions, whereas interest on debt that is linked to a reference price index should be classified as variable-rate, provided that the prices that are the basis for the reference index are market-determined.

4.222. The classification of a financial asset or liability can change over time, for example, if it switches from fixed- to variable-rate interest. In the period when a fixed rate is applied, the

financial asset or liability is to be classified as fixed-rate debt. After the rate switches to variable, it is classified as variable-rate debt.

4.223. Indexed instruments are classified as variable-rate. For these instruments, the principal or coupons or both are indexed to some variable, for example, to a general or specific price index. Because indexed instruments have variable aspects, an instrument is classified as variable-rate if the indexation applies to the principal or coupons, or both. A foreign-currency-linked instrument is treated as denominated in the foreign currency, rather than indexed.

4.224. If interest is linked to a reference index, commodity price, or financial instrument price, but is fixed unless the reference index or price passes a particular threshold, it should be regarded as fixed-rate. If, thereafter, interest becomes variable, then it should be reclassified as a variable-rate instrument. Alternatively, if interest is variable-rate until it reaches a predetermined ceiling or floor, the instrument becomes fixed-rate debt when that ceiling or floor is reached. If the income stream of a variable-rate instrument is swapped with the income stream of a fixed-rate instrument, the swap is recorded as giving rise to a financial derivative, while the classification of the original debt instruments is unchanged.

C. Other Classifications

4.225. For some analysis, additional cross-classifications of financial assets and liabilities may be useful. These classifications may include: (1) loans broken down by economic activity (according to standard industry classification); (2) loans to household by purpose (such as for mortgage, or education, or auto, or other durable goods); (3) loans to nonresidents by jurisdiction (including individual country or region); (4) debt and equity securities distinguished between listed ones and unlisted ones; (5) investment fund shares distinguished between listed and unlisted; and (6) assets composition of investment funds (including debt securities, equity, commodity-linked investments, real estate, shares in other investment funds, and structure assets).

VI. CONTINGENCIES

4.226. Many types of contractual financial arrangements between institutional units do not give rise to unconditional requirements either to make payments or to provide other economic assets. These arrangements, which are often referred to as *contingencies* (or off-balance sheet exposures) are not defined as financial assets or financial liabilities and should not be recorded in the balance sheets of FCs. For example, guarantees of payment by third parties are contingencies, because payment is only required if the principal debtor defaults. Lines of credit provide guarantees that funds will be made available, but no financial asset (i.e., loan) is created until funds are actually advanced. Letters of credit are promises to make payment only when certain documents specified by contract are presented. Note issuance facilities (NIFs) provide guarantees that parties will be able to sell short-term securities (notes) that they issue and that the FC providing the facility will purchase any notes not sold in the market. Only if the financial corporation providing the facility makes funds available will it acquire an actual asset, to be recorded in the balance sheet.

4.227. Even though excluded from the monetary and financial statistics, data on contingencies should be reported to the compilers of monetary and financial statistics. Standards for measuring contingent liabilities are still evolving because these liabilities are complex arrangements and no single measurement approach can fit all situations.⁷² Nonetheless, monitoring and measurement of contingent liabilities are encouraged, with a view to enhancing transparency.

DRAFT

⁷² The *Public Sector Debt Statistics Guide for Compilers and Users* (paragraphs 4.23-4.26) and the *External Debt Statistics Guide for Compilers and Users 2013* (paragraphs 9.20-9.46) discuss some techniques for measuring contingent liabilities and recommend reporting or disclosure of selected measures.

Annex 4.1. Accounts with the IMF

Introduction

4.228. This annex describes the recommended treatment of accounts with the IMF (the Fund) in monetary statistics. This subject warrants particular attention because of the special characteristics of member countries' financial relations with the Fund and the special accounting procedures used by member countries for recording their financial positions with the Fund.

4.229. The Fund is a cooperative intergovernmental monetary and financial institution. Its policies and activities are guided by its charter, known as the Articles of Agreement (the Articles). The Fund is unique among intergovernmental organizations in its combination of regulatory, consultative, and financial functions.⁷³

4.230. The Fund maintains a large pool of resources from which it can draw funds to help finance temporary imbalances in the balance of payments of its members. These resources are of a revolving character and are derived from deposits made by member countries at the time they join the Fund or when their quota subscriptions are increased following periodic reviews of the quotas. The Fund can supplement these resources temporarily by borrowing from its members, including through issuance of debt instruments (such as, IMF Notes).

4.231. The use of Fund resources under non-concessional terms often takes place within the framework of Stand-By or Extended Fund Facility (EFF) Arrangements⁷⁴ between the member and the Fund. In such cases, a member acquires Fund resources by using its currency to purchase SDRs or readily usable foreign exchange from the Fund. To settle obligations to the Fund arising from the use of Fund resources, a member repurchases its currency from the Fund using SDRs or foreign exchange. All accounts and transactions of the Fund are denominated in SDRs.

4.232. More recently (in 2009 and 2011, respectively), in response to the global financial crisis the IMF introduced new arrangements in a form of credit lines, such as the Flexible Credit Line (FCL) and the Precautionary and Liquidity Line (PLL). FCL arrangements are for countries with very strong fundamentals, policies, and track records of policy implementation, and are approved for countries meeting pre-set qualification criteria at the member country's request. PLLs are for countries with sound fundamentals and policies that face moderate vulnerabilities and may not meet the FCL qualification standards.

4.233. On several occasions, the Fund has acted as a source of additional international liquidity through the creation and allocation to its members of SDRs, a reserve asset that can

⁷³ For a detailed discussion of the Fund's financial organization and operations, see International Monetary Fund, *Financial Organization and Operations of the IMF*, IMF Pamphlet Series, No. 45 sixth edition (Washington: International Monetary Fund, 2001).

⁷⁴ The full list of IMF lending instruments and their descriptions can be found at <http://www.imf.org/external/np/exr/facts/howlend.htm>.

be transferred among Fund members and other authorized holders including the Fund. The Fund also maintains a range of concessional financial arrangements, including the Poverty Reduction and Growth Trust (PGRT), formerly called the Enhanced Structural Adjustment Facility (ESAF) Trust, in which it technically acts as trustee.

4.234. New concessional facilities for low income countries (LICs) became effective in 2010 under the PRGT as part of a broader reform to make the Fund's financial support more flexible and better tailored to the diverse needs of LICs. These new facilities include the Extended Credit Facility (ECF) that succeeds the Poverty Reduction and Growth Facility (PRGF), the Standby Credit Facility (SCF), and the Rapid Credit Facility (RCF).

4.235. The financial transactions and operations of the Fund are conducted through the General Department, the SDR Department, and the Administered Accounts, which include the IMF Managed Trust Accounts. The bulk of transactions between member countries and the Fund take place through the General Resources Account (GRA), which is part of the General Department. This account handles the receipt of quota subscriptions, purchases and repurchases, receipt and refunding of charges, payment of remuneration on members' loan claims and on creditor positions in the Fund, and repayment of principal to the Fund's lenders. The assets held in the GRA comprise currencies of Fund member countries and the Fund's own holdings of SDRs and gold. The SDR Department records all transactions and operations involving SDRs. The Administered Accounts are legally and financially separate from all other accounts of the Fund. They represent resources that have been contributed by members and held by the Fund for purposes that are consistent with the Articles, such as financial and technical assistance.

Recording of IMF accounts

4.236. The principles relating to sectoring, classification of financial instruments, and valuation that this *Manual* recommends apply equally to the treatment of Fund accounts. Thus, the central bank's SDR-denominated positions with the Fund should be valued (in domestic currency) at market exchange rates, and assets and liabilities should be recorded on a gross basis. All transactions with the Fund are classified as transactions with nonresidents.

4.237. The following section describes the procedures in the monetary statistics when all Fund accounts are recorded in the central bank balance sheet. This is followed by a discussion of the statistical treatment of Fund accounts for countries in which positions and transactions with the Fund are shared between the central bank and the government.

Case 1: The central bank's balance sheet includes all Fund accounts

4.238. In the majority of member countries, the central bank has been designated as a depository and fiscal agency for the country's financial relationship with the Fund,⁷⁵ and so is

⁷⁵ Each member designates a fiscal agency (ministry of finance, central bank, of similar entity) to conduct financial transactions with the IMF and a depository (central bank or similar agency) to maintain the *accounts of the IMF*.

the sole institution that transacts with the Fund. In such cases, the central bank records all of the member's transactions with the Fund and the member's balances in the various Fund accounts.

Basic balance sheet presentation

4.239. The balance sheet of the central bank will then normally include the following:

On the assets side:

- (a) SDR holdings that can be acquired through allocations by the Fund or through transactions with the Fund or other designated holders.
- (b) Claims on the IMF arising from (1) the country's payment of its total quota subscription in both reserve assets and domestic currency; (2) loans to the Fund; and (3) holdings of the IMF Notes (see paragraph 4.240e below).
- (c) Claims on the IMF Managed Trusts arising from the loans made by the member to the IMF managed trusts.

On the liabilities side:

- (a) Deposits of the IMF at the country's central bank that are maintained in the *IMF No. 1 and No. 2 accounts*⁷⁶ and, in some cases, in the *IMF Securities Account*.⁷⁷ Balances in IMF No. 1 and IMF Securities Account are created by (1) the payment of the domestic currency component of the quota subscription and (2) purchases of the Fund's resources (normally in the form of SDRs or convertible foreign currency) in exchange for domestic currency. Such purchases are conducted through the GRA. They can include the use of the country's reserve tranche (discussed below) and use of Fund credit under various Fund facilities, principally Stand-By and Extended Fund Facility.
- (b) Loans received from the IMF that are provided through accounts administered by the Fund; loans through Poverty Reduction and Growth Trust (PRGT) are the principal example.
- (c) SDR allocations that are provided to member countries by the Fund.

⁷⁶ The IMF No. 2 Account is used for the IMF's administrative expenses and receipts (such as from sales of IMF publications) in the member's currency and within its territory.

⁷⁷ A member may establish an IMF Securities Account in order to substitute parts of holdings in the IMF No. 1 Account with nonnegotiable, non-interest-bearing notes, or similar instruments payable to the IMF on demand when the currency is needed for the IMF's transactions.

- (d) Revaluations, recorded in the *valuation adjustment* account under *equity*, reflect the counterparts to changes, positive or negative, in all of the above positions with the Fund that are due to changes in the market exchange rate between the member's currency and the SDR.

Analytical presentation

4.240. A country's financial position with the Fund can also be presented in an analytic format that focuses on the components of IMF-related assets that are considered to be reserve assets and IMF-related liabilities that arise from the use of Fund credit and loans. Positions with the Fund in the analytic format are used in the compilation of the central bank survey recommended in the *MFSMCG* (refer to Central Bank Survey in Chapter 7). These positions, shown in Table 4.7, identify the following IMF-related positions:

- (a) SDR Holdings. This item can be directly identified in the balance sheet of the central bank.
- (b) Reserve tranche position in the IMF. The reserve tranche position in the Fund is an international reserve asset that represents a member's automatic (unconditional) drawing right in the Fund, created by the payment of the foreign exchange component of the quota subscription and capable of being expanded by the Fund's use of the member's currency in its transactions with other member countries.⁷⁸

Reserve tranche position in the IMF can be calculated by using an algebraic relationship between a country's claims on and liabilities to the IMF. *Reserve tranche position in the IMF* is equal to *IMF Quota* minus Fund's holdings of the member's currency (the balances in the *IMF No. 1 and No. 2 Accounts* and *IMF securities account*) that are *not subject to exclusion*.⁷⁹ A member's reserve tranche position cannot be constructed directly from information in the sectoral balance sheet of the central bank; detailed accounting records of the country's transactions with the Fund are required to identify separately the components of Fund holdings of the member's currency that are needed for the calculation. In particular, data on the *Use of Fund credit* are required for the computation of the *Reserve tranche position in the IMF*.

⁷⁸ For example, if member A purchases member B's currency in the course of using Fund resources, the Fund's holdings of B's currency fall, and there is an equal increase in B's reserve tranche position. This increase in B's reserve tranche position recognizes the possibility that A will ask B to exchange its domestic currency for reserve assets such as U.S. dollars or SDRs.

⁷⁹ *IMF No. 1 Account* and *IMF Securities Account* balances **not subject to exclusion** are liabilities to the Fund, which are used to cover the country's IMF quota subscription. Balances **subject to exclusion** are liabilities that are the contra-entries to a country's use of IMF resources (that is, purchase of SDRs or other foreign exchange) through the IMF's GRA. Balances in the *IMF No. 2 Account* that are less than 1/10 of 1 percent of the member's quota are also subject to exclusion.

- (c) Loans to the IMF. The central bank's loans to the IMF can be identified directly in the balance sheet of the central bank. These loans give rise to a claim on the IMF. If the claim is readily encashable to meet the balance of payments financing need, the loan should be classified in *Loans, IMF (Official Reserve Assets)*. All other loans should be classified in *Loans, IMF (Other)*.⁸⁰
- (d) Loans to the IMF Managed Trusts. The central bank loans to the IMF Managed Trusts (MT) can be directly identified in the balance sheet of the central bank. The loans that give rise to a claim that is readily encashable to meet the balance of payments financing need should be classified in *Loans, IMF-MT (Official Reserve Assets)*. All other loans should be classified in *Loans, IMF-MT (Other)*.
- (e) Holdings of IMF Notes. IMF notes are issued by the IMF as means of supplementing its resources for providing financial assistance to its members. The central bank's holdings of the IMF Notes can be directly identified in the balance sheet of the central bank. These notes give rise to a claim on the IMF. If the claim is readily encashable to meet the balance of payments financing need, the note should be classified in *Debt Securities, IMF (Official Reserve Assets)*. All other notes should be classified in *Debt Securities, IMF (Other)*.

Classification of *Loans to the IMF*, *Loans to the IMF Managed Trusts*, and the *IMF Notes* in accordance with their encashability to meet the balance of payments financing needs is important. It is essential for the compilation of the analytical accounts shown in Tables 4.7 and 4.8. It also promotes consistency of monetary data with the data for *International Reserves and Foreign Currency Liquidity*. For this purpose, Table 3 provides guidance on classifying *Loans to the IMF*, *Loans to the IMF Managed Trusts*, and the holdings of *IMF Notes* in the central bank sectoral balance sheet/SRF-1SR consistent with the treatment recommended in the *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template (2013)*.

- (f) Use of Fund credit. This item measures the member's outstanding purchases of Fund resources through the GRA, the counterparts of which are increases in the member's domestic currency liabilities to the Fund. Outstanding purchases of Fund resources through the GRA are equal to all purchases minus repurchases, excluding transactions within the reserve tranche. Detailed records of the member's transactions with the Fund are required to identify the components of the Fund's holdings of the member's currency that arise from the use of Fund credit.

⁸⁰ Classification of loans to the IMF and holdings of notes issued by the IMF in the official reserve assets is discussed in Appendix VIII of the *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template (2012)*.

- (g) Loans from the IMF. This item can be directly identified in the balance sheet of the central bank.

Table 4.7. IMF-Related Reserve Assets and Liabilities – Analytical Presentation	
Assets	Liabilities
<p>Claims on Nonresidents</p> <p>Official Reserve Assets</p> <ul style="list-style-type: none"> (i) SDR holdings (ii) Reserve tranche position in the IMF (iii) Loans to the IMF (Official Reserve Assets) (iv) Debt Securities, IMF (Official Reserve Assets) (v) Loans to IMF-MT (Official Reserve Asset) <p>Other Foreign Assets</p> <ul style="list-style-type: none"> (i) Loans to IMF (Other) (ii) Debt Securities, IMF (Other) (iii) Loans to IMF-MT (Other) 	<p>Liabilities to Nonresidents</p> <ul style="list-style-type: none"> (i) Use of Fund credit (ii) Loans from the IMF (iii) SDR allocations

4.241. Table 4.8 shows the balance sheet records at the central bank for the Fund accounts and their transition to the analytical presentation.

Table 4.8. Fund Accounts: Balance Sheet and Analytical Presentation for a Central Bank Designated as Fiscal and Depository Agency

Balance Sheet of the Central Bank (in domestic currency)			
Assets	142.0	Liabilities	207.10
Quota subscription in the IMF	120.00	IMF No. 1 Account	60.00
SDR holdings	7.00	IMF No. 2 Account	0.10
Loans to the IMF	5.00	IMF Securities Account	100.00
Loans to the IMF (Official Reserve Assets)	3.00	Loans from the IMF (for example, PRGF)	15.00
Loans to the IMF (Other)	2.00	SDR allocations	32.00
IMF Notes	6.00		
IMF Notes (Official Reserve Assets)	6.00		
IMF Notes (Other)	0.00		
Loans to IMF Managed Trusts	4.00		
Loans to IMF Managed Trusts (Official Reserve Assets)	0.00		
Loans to IMF Managed Trusts (Other)	4.00		

Calculation of Reserve Tranche Position in the IMF:

RTP = Quota subscription in the IMF – Fund’s holdings of the member’s currency that are not subject to exclusions

Fund’s holdings of the member’s currency that are not subject to exclusions = Total holdings – Exclusions

Fund’s holdings of the member’s currency (total) = IMF No. 1 Account + IMF No. 2 Account + IMF Debt Securities Account = 60 + 0.1 + 100 = 160.1

Fund’s holdings of the member’s currency that are subject to exclusions = Holdings arising from UFC + IMF Account No. 2 if less than 1/10 of 1 percent of the Quota in the IMF

Given the data on UFC = 50, obtained from the detailed records at the central bank:

Fund’s holdings of the member’s currency that are subject to exclusions = 50 + 0.1 = 50.1

Therefore, Fund’s holdings of the member’s currency that are not subject to exclusions = 160.1 - 50.1 = 110

Then, RTP = 120 - 110 = 10

Analytical Presentation (in domestic currency)			
Assets		Liabilities	
Claims on Nonresidents	32.00	Liabilities to Nonresidents	97.00
<i>Official Reserve Assets</i>	<i>26.00</i>	Use of Fund Credit and Loans Outstanding	65.00
Reserve Position in the IMF	19.00	Use of Fund Credit	50.00
Reserve Tranche Position in the IMF	10.00	Loans from the IMF	15.00
Loans to the IMF (Official Reserve Assets)	3.00	SDR allocations	32.00
IMF Notes (Official Reserve Assets)	6.00	Other liabilities	0.10
SDR holdings	7.00	IMF No. 2 Account	0.10
Loans to IMF Managed Trusts (Official Reserve Assets)	0.00		
<i>Other Foreign Assets</i>	<i>6.00</i>		
Loans to the IMF (Other)	2.00		
IMF Notes (Other)	0.00		
Loans to IMF Managed Trusts (Other)	4.00		

4.242. Table 4.9 provides guidance on classifying *Loans to the IMF*, *Loans to the IMF Managed Trusts*, and the holdings of *IMF Notes* in the central bank sectoral balance sheet/SRF-1SR consistent with the treatment recommended in the *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template (2013)*, Table 8.1.

Table 4.9. IMF Accounts: Loans and Notes

Claim or Commitment to Lend	For information: Statistical Treatment in the <i>International Reserves and Foreign Currency Liquidity Data Template</i>	Statistical Treatment in the Central Bank Sectoral Balance Sheet/SRF-1SR
Bilateral Loan Agreements (BLAs; undrawn amounts) for loans that would be readily available to meet balance of payments financing needs	Do not report in the Reserves Data Template. (They should not be reported as contingent drains in Section III.4.)	Excluded.
Loans (readily available to meet a BoP financing need) drawn by the IMF under BLAs	Increase in RPF in Section I.A.	<i>Loans, IMF (Official Reserve Assets)</i>
BLAs (undrawn amounts) for loans that would not be readily available to meet BoP financing needs	Do not report in the Reserves Data Template	Excluded.
Loans (not readily available to meet a BoP financing need) drawn by the IMF under BLAs	Do not report in the Reserves Data Template	<i>Loans, IMF (Other)</i>
Note Purchase Agreements for Series A notes (readily available to meet BoP financing needs)	Do not report in the Reserves Data Template. (They should not be reported as contingent drains in Section III.4.)	Excluded.
Holdings of Series A Notes (available to meet balance of payments financing needs)	Increase in RPF in Section I.A.	<i>Debt Securities, IMF (Official Reserve Assets)</i>
Note Purchase Agreements for Series B notes (not readily available to meet balance of payments financing needs)	Do not report in the Reserves Data Template	Excluded
Holdings of Series B Notes	Do not report in the Reserves Data Template, because the notes do not qualify as reserve assets	<i>Debt Securities, IMF (Other)</i>
Lending to IMF managed trust accounts (readily available to meet balance of payments financing needs)	Include in other reserve assets (item I.A.(5))	<i>Loans, IMF-MT (Official Reserve Assets)</i>
Lending to IMF managed trusts (not readily available to meet balance of payments financing needs)	Do not report in the Reserves Data Template, because these loans do not qualify as reserve assets	<i>Loans, IMF-MT (Other)</i>
Commitments under the GAB and NAB	Do not report in the Reserves Data Template	Excluded.

Claim or Commitment to Lend	For information: Statistical Treatment in the <i>International Reserves and Foreign Currency Liquidity Data Template</i>	Statistical Treatment in the Central Bank Sectoral Balance Sheet/SRF-1SR
Drawings under the GAB and NAB	Increase in RPF in Section I.A.2.	<i>Loans, IMF (Official Reserve Assets)</i>
SDR holdings	Report in Section I.A.3, SDRs	<i>SDR holdings</i>
SDR allocations	Do not report in the Reserves Data Template	<i>SDR allocations</i>
SDR accrued interest	The preferred reporting treatment is to omit accrued interest on holdings from Section I.A.3, and to report the net amount of interest receivable or payable in future periods either as a pre-determined outflow (if negative) or inflow (if positive) in Section II.1. Alternately, it is acceptable to include accrued interest on holdings in Section I.A.3, and to report the gross amount of interest that will be payable in future periods on allocations in Section II.1, as an outflow of interest.	Accrued interest should be incorporated in the <i>SDR holdings</i> and <i>SDR allocations</i> positions.

Case 2: Fund Accounts are included in the balance sheets of the Central Bank and the Ministry of Finance

4.243. In a number of countries, not all transactions with the Fund are undertaken by the central bank. In most of these countries, the Ministry of Finance has been designated as the fiscal agency for the country's financial relationship with the Fund and undertakes transactions with the Fund without central bank involvement, which typically is designated as the depository agency. The central bank's balance sheet may record only partial balances in the IMF Quota subscription, No. 1, No. 2 and Securities accounts, while all other positions with the Fund are financial assets and liabilities of the government. A typical example of such a situation would have the quota subscription, SDR holdings and allocations, and balances in the securities account outside the balance sheet of the central bank. It should be noted that, while the accounting presentation for this case differs from that in the previous section, the analytical format (as shown in Table 4.7) for the monetary authorities accounts would be the same.

4.244. Many users of monetary statistics find it useful for analytical and financial programming purposes to combine all of the members' positions with the Fund in a single set of accounts. This technique is also often applied to currency issue and transactions in other international reserve assets undertaken by the Ministry of Finance or other agencies outside

the central bank. The resulting augmented central bank balance sheet is commonly known as the monetary authorities accounts. (See Chapter 7, Section IV, Subsection C).

4.245. The inclusion of Fund account positions of the government in the monetary authorities accounts expands the gross foreign assets and liabilities recorded in that account and enables it to be linked directly to the changes in Fund-related international reserve assets and reserve-related liabilities that are recorded in the external sector statistics. It also creates a need for contra-entries in the monetary authorities' accounts to ensure the integrity of the double-entry accounting system. For example, when a country's quota position in the Fund and the associated balances in the IMF No. 1 Account and the IMF Securities Account are moved from the balance sheet of the Ministry of Finance to the monetary authorities' accounts, the monetary authorities acquire a foreign asset (the Reserve Tranche Position) and a corresponding liability to the government. Similarly, when the monetary authorities acquire from the government liabilities to the Fund arising from the Use of Fund Credit or the IMF loans, they acquire a liability to nonresidents and a corresponding claim on the government.

4.246. One way of recording the contra-entries arising from the inclusion of the government's positions into the monetary authorities accounts is to record the contra-entries on a net basis in a separate government account ("Fund consolidation account") on the asset side either as a component of net credit to government or as a separate asset category. With this treatment, a transaction with the Fund undertaken by the government may or may not result in changes in net credit to government, as recorded in the monetary authorities accounts.

4.247. In compiling monetary authorities accounts that includes government positions with the Fund, care should be taken to avoid the introduction of valuation and other adjustments that could distort among other things, the measurement of net claims on government. For a fuller description on how the monetary authorities' accounts are compiled including for Fund accounts, please refer to paragraphs 7.62–7.65 and Table 7.13 in Annex 7.4.

Annex 4.2. Islamic Financial Institutions and Instruments⁸¹

4.248. This annex describes how Islamic financial institutions operate under the Islamic principles (*Shari'a*) and how they differ from conventional financial institutions. For the purpose of compiling monetary statistics, various types of Islamic financial instruments are discussed in comparison to those of conventional financial institutions. This subject warrants special discussion due to the increasing number of countries that have Islamic financial institutions and the growing numbers of Islamic financial institutions in some countries.

4.249. Islamic financial system refers to a financial system or financial activity that follows the principles of *Shari'a*. *Shari'a*, which denotes the Islamic law that governs the entire framework of activities in Islam, includes law regulating economic and financial activities in order to ensure fair transactions and economic justice. Even though *Shari'a* principles have existed throughout the Islamic history, the application of *Shari'a* principles in modern Islamic financial system began only in the last quarter of 20th century, with the formation of Islamic Development Bank (IDB) in 1973.

4.250. The Islamic financial regulatory bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)⁸² and the Islamic Financial Services Board (IFSB) have made efforts to develop regulatory framework and accounting standards for Islamic financial institutions which include capital adequacy and risk management framework, as well as in accounting, auditing, corporate governance, *Shari'a*, and ethical standards. These efforts are aimed at ensuring a safe and sound Islamic financial system (*Shari'a* compliance) and to effectively integrate and harmonize the Islamic financial system and practices within the international financial system.

4.251. Although both Islamic and conventional financial institutions are for-profit entities, their philosophy and operations are different in that for Islamic financial institutions *Shari'a* prohibits financial transactions associated with: (i) pre-determined interest (*Riba*) for lending and borrowing; (ii) uncertainty (*Al-Gharar*)—no contracts or contingents on the occurrence or non-occurrence of an uncertain future event; (iii) speculation (*Al-Maisir*)—conversely, trading or transactions entailing a chance of gain or risk of loss are allowed. Commercial trade and investment for profit are acceptable and encouraged. Islamic financial institutions use either trading models or profit and loss sharing models in financing customer's needs, participate in investments that meet *Shari'a* principles, and earn fees for services rendered. For example, Islamic financial institutions offer investors /depositors participation in risk-bearing, open-ended, mutual fund-type packages rather than fixed interest on deposits. In addition, *Shari'a* also prohibits financial transactions associated with businesses that produce goods and services considered contrary to its principles, like tobacco, alcohol, gambling, vulgar entertainment, etc.

⁸¹ This annex draws on Zubair Iqbal and Abbas Mirakhor, *Islamic Banking* (Washington: International Monetary Fund, 1987); and Muhammad Hanif, *Islamic Banking, Theory and Practice* (2nd edition, 2012).

⁸² The AAOIFI is a self-regulatory international autonomous non-profit organization that was established in 1991 in Bahrain. The IFSB, which is based in Kuala Lumpur, was officially inaugurated on November 3, 2002, and started operations on March 10, 2003.

4.252. Several special types of depository accounts and financial instruments permit Islamic financial institutions to engage in some commercial banking activities. Generally, any risk-bearing instrument reflecting a real asset and earning a variable rate of return tied to the performance of the asset is considered to be consistent with *Shari'a*. Use of financial instruments with returns specified before investment is not permitted, but sharing of the returns by some formula after the fact is acceptable. Some financial activities may have an established rate of return that could be created, for example, by the purchase and resale of trade goods at trade margins (cost plus profits) affected by market competition or standard practices (called *Murabaha*). Generally, *Murabaha* is a dominant model of financing in the portfolios of Islamic financial institutions due to its easiness and low risk as compared to profit and loss sharing models of financing.

4.253. The functions of Islamic financial institutions can be divided into two parts: the safeguarding of deposits and the partnership of financial institutions with shareholders and depositors in profit-making ventures. Demand deposit facilities (called *Wadiah* or *Amanah deposits*) are similar to the safekeeping and transferable deposit functions performed in standard commercial banking. The *Wadiah* or *Amanah* deposits pay no returns, and the financial institution is obligated to preserve the nominal value of the deposit. For purposes of preparing monetary statistics, Islamic deposit facilities should be treated in the same way as standard deposits in DCs.

4.254. The partnership activities of Islamic financial institutions have mixed features that include conventional bank intermediation, mutual funds, or limited partnerships. To a large extent, Islamic financial institutions act as conventional intermediaries by issuing deposit-like instruments to the public, in order to raise funds to finance commercial activity. The deposit-like instruments and the financial institutions' investments must be designed to expose both the depositors and the financial institutions to profits or losses on the ventures. Thus, the investments—many are negotiable and known by names such as “participation term certificates,” “profit and loss sharing (PLS) certificates,” and “investment deposit certificates”—have properties similar to those of shares in a company or a mutual fund.

4.255. An Islamic financial institution serving as an intermediary may act as a partner or as a provider of services in profit-making ventures and thus has some characteristics in common with mutual funds, financial leasing companies, or brokers. Because of the joint participation among an Islamic financial institution, shareholders, and depositors in equity investments, the financial institution per se is not as exposed to risk as is a conventional, commercial, financial intermediary. In addition, the structure of the balance sheet of an Islamic financial institution may differ from that of a standard commercial depository corporation. For example, the equity capital base of an Islamic financial institution may be larger than that of a commercial depository corporation; an Islamic financial institution's loan portfolio may be concentrated in short-term trade instruments; and the nature of banking strategies and risks may differ.

4.256. The prevailing statistical practice is to classify Islamic financial institutions that have liabilities in the form of deposits or financial instruments that are close substitute for deposits in the ODCs subsector. The implication of this practice is that participation certificates and other investment deposits are treated in the same way as regular deposits for statistical reporting purposes. The participation of many Islamic financial institutions in bank clearing

systems and a concentration of lending activity in traditional, short-term commercial and trade financing are practices that tend to reinforce this classification. Islamic financial institutions that are not primarily involved in deposit-taking activities are classified as OFCs. Islamic financial institutions investing mainly as long-term partners in business ventures are akin to MMFs, and the liabilities of these financial institutions to the public should be classified as deposits.

4.257. As intermediary institutions, Islamic financial institutions like conventional financial institutions also issue deposits (current, savings, and fixed-term deposits) or deposit-like instruments as their sources of funds. The following list details sources of funds for Islamic financial institutions.

- (a) Wadiah and Amanah deposits can be withdrawn on demand, at par, without penalty or restriction, and generally usable for making payments by check, draft, giro order, or other direct payment facilities. This type of deposits are not linked to any profit-making ventures and are not part of the profit and loss sharing schemes, hence financial institutions have the flexibility to use the funds but are required to guarantee the face value of the deposits. With the foregoing characteristics, these deposits usually offer no (or very small) returns to the depositors. In the context of compiling monetary statistics, these deposits are classified as transferable deposits.
- (b) A Mudarabah, also known as Profit Sharing Investment Account (PSIA), is a contract between investors and a financial institution that, as a silent partner, invests the deposits in a commercial venture. Profit sharing of the venture is pre-determined on the basis of risk and return, and the financial institution and investors share any profit generated from the venture. A *Mudarabah* can be entered into for a single investment or on a continuing basis with the financial institution acting as a fiduciary. Similar to the case of deposits at conventional financial institutions, *Mudarabah* can be divided into the following types: (i) *Mudarabah* accepted without time frame (not fixed), hence the investors are free to withdraw their money at any time—this type of deposits are similar to those of savings deposits at conventional financial institutions; (ii) *Mudarabah* accepted for a fixed period that provides opportunity for financial institutions to invest in more profitable long-term projects—this type of deposits are similar to time deposits at conventional financial institutions and usually generate higher profits in comparison to the former type; and (iii) *Mudarabah* accepted for fixed terms and arranged through negotiable instruments (called investment deposit certificates or *Mudarabah* certificates) and thus may have characteristics similar to those of debt securities.
- (c) Qard-hasan deposits are return-free deposits voluntarily placed by depositors, to participate in the financing for needy individuals or for social purposes. This type of deposits is classified as other deposits in the compilation of monetary statistics.

- (d) Zakat funds are special funds that are maintained by Islamic financial institutions, used for social purposes, and financed by contributions from depositors. *Zakat* funds are not part of the financial institution's sources of funds.
- (e) Participation term certificates are long-term investment instruments that entitle the holder to a share of a corporation's profit. These certificates should be classified as deposits if the certificates are treated as liabilities of a financial institution and are not part of its capital base.
- (f) Profit and loss sharing certificates and investment deposit certificates are investors' deposits, such as *Mudabarah* certificates, that resemble shares in a company and should be classified as deposits. If *Mudarabah* certificates are negotiable, they should be classified as debt securities.
- (g) Sukuk, also known as Islamic bonds, are investment certificates issued by Islamic financial institutions as a way to obtain funding through offering corporate *Sukuk*. The following three types of *Sukuk* contracts are the most prominent: (i) *Sukuk Ijara*; (ii) *Sukuk Murabaha*; and (iii) *Sukuk Musharakah*, which are all negotiable instruments. In recent years, *Sukuk* have become very popular as an alternative mean of raising government finance through sovereign issues. A distinguishing feature of *Sukuk* is that the holders are entitled to share revenues generated by the *Sukuk* assets and are entitled to a share in the proceeds of the realization of *Sukuk* assets. Hence *Sukuk* holders claim an undivided beneficial ownership in the underlying assets. Governments, central banks, financial or nonfinancial corporations, and supranational organizations can issue *Sukuk*. For the purpose of compiling monetary statistics, *Sukuk* should be classified as debt securities.

4.258. On the financing side, Islamic financial institutions invest money collected from investors in some commercial ventures by using either trading models or profit and loss sharing models. The following list covers the primary types of financing provided by Islamic financial institutions.

- (a) Qard-hasan loans are return-free loans that are made to needy individuals or for some social purpose. *Qard-hasan* loans are usually extended on a goodwill basis, and the debtor is required to repay only the principal amount of the loans. The debtor may, however, at his or her discretion, pay an extra amount beyond the principal amount of the loans (without promising it) as a token of appreciation to the creditor.
- (b) Murabaha refers to contracts in which a financial institution purchases goods upon the request of a client, who makes deferred payments that cover costs and an agreed-upon profit margin for the financial institution. The financial institution handles payments to the supplier including direct expenses incurred (delivery, insurance, storage, fees for letter of credit, etc.). Operating expenses of financial institutions are not included.

Under *Murabaha* contracts, disclosure of cost of the underlying goods is necessary. In compiling monetary statistics, *Murabaha* should be classified as loans.

- (c) A Bai Muajjal is a type of financing provided by a financial institution to its client by supplying desired commodities or services with deferred payments. In compiling monetary statistics a *Bai Muajjal* is classified as trade credits within other accounts receivables.
- (d) A Bai Salam is a short-term agreement in which a financial institution makes full prepayments (spot payment) for future delivery of a specified quantity of goods on a specified date. In practice, farmers usually need money to purchase seeds and fertilizers. A financial institution and farmers in this case may engage in a *Bai Salam* contract, in which farmers agree to sell their crops to financial institutions prior to harvesting. Generally, the agreed spot price is less than the future price of the commodities, in order for the financial institution to make profits. A *Bai Salam* should be classified as a trade credit and advance.
- (e) An Istina'a is a partnership between a financial institution and an enterprise, usually manufacturer or construction company, in which the financial institution place an order and provide financing to the enterprise to manufacture/construct and or supply certain goods or construction buildings. Upon or before the delivery of the order, financial institutions may engage into a contract of parallel *Istina'a* with another party at a price higher than the original contract of the *Istisna'a*, thus making profits for the financial institutions. An *Istisna'a* should be classified as a loan.
- (f) An Ijara is a lease-purchase contract in which a financial institution purchases capital equipment or property and leases it to an enterprise. The financial institution may either rent the equipment or receive a share of the profits earned through its use. Ownership risks of the assets are borne by the financial institution; expenses related to the use of the assets are the responsibility of the client. An *Ijara* should be classified as a loan.
- (g) An Ijara Wa Iktina is the same as *Ijara* except that the lessee can acquire ownership of the asset by making installment payments. An *Ijara Wa Iktina* should be classified as a loan.
- (h) A Musharakah is a partnership between a financial institution and an enterprise in which the financial institution provides working capital. In a *Musharakah* partnership, the financial institution and client agree to share any profits generated from the venture according to the pre-agreed ratio; a loss is shared according to the ratio of contribution. A *Musharakah* should be classified as a loan.
- (i) A Mudarabah financing is a partnership between a financial institution and a client in which the financial institution provides capital (*rab al maal*) and the client provide

skillful labor (*mudarib*). *Mudarabah* financing is a type of partnership whereby skill and money are brought together to conduct business and where profit generated from the business is shared according to the agreement while loss is borne fully by the financial institution as the capital provider.

4.259. A Takaful is Islamic insurance that has emerged to complement the vast growing Islamic financial institutions, as an alternative form of conventional insurance. *Takaful* was invented as an Islamic way of mutual assistance to deal with uncertainties (*Al-Gharar*) of life. Islamic societies in different parts of the world are now practicing *Takaful* scheme which is based on the concept of pooling losses that does not contradict with the *Shari'a* principles; it is their own way of sharing financial responsibilities to assist each other. The compensation to the unfortunate member and group responsibility are not only accepted, but also encouraged in Islam. The growth of *Takaful* companies not only would serve as the vehicle of risk pooling, but also as alternative means of investment. In the context of compiling monetary statistics, a *Takaful* company should be classified as an OFC while its claims and liabilities related to its main activities as a *Takaful* company (i.e., participants' contributions (*Tabarru'*), *Re-Takaful* contributions, and claims or compensations related to the *Takaful* policies) should be classified as *equity and investment fund shares*.

4.260. The 2008 SNA classification scheme for financial instruments provides additional detail that compilers may use to separately identify Islamic financial instruments. For example:

- (a) Islamic instruments—deposits include transferable deposits and other deposits as well as various investment participation certificates that are not investments in the permanent capital of a financial institution and do not have the characteristics of tradable securities.
- (b) Islamic instruments—debt securities consist of various investment participation certificates that have the characteristics of tradable securities and are not investments in the permanent capital of a financial institution. Included in this category are the most tradable investment certificates recorded as liabilities of a financial corporation.
- (c) Islamic instruments—loans cover arrangements in which a financial institution makes prepayments, finances ventures or trade, or supplies working capital to clients. The arrangements may include short-term or other partnerships in which a financial institution is not making permanent, equity-type investments.
- (d) Islamic instruments—equity and investment fund shares include various investment participation certificates that are part of the permanent capital of a financial institution or are clearly representative of a partnership between an investor and a financial corporation.