



Balance of Payments Division
IMF Statistics Department



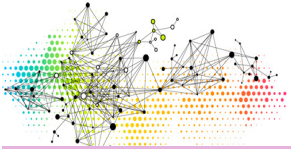
Financial Instruments (L4)

Course on External Sector Statistics

Nay Pyi Taw, Myanmar

January 19-23, 2015

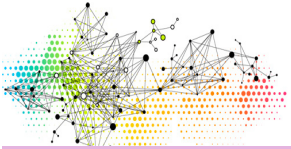
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General Overview

- Definitional issues
- Classification of financial instruments
 - *Three broad categories*
- Summary of changes in the treatment of specific instruments in the *BPM6*

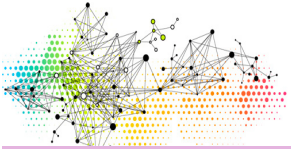
References: *BPM6* Chapters 5, 6, and 8



Definitional Issues

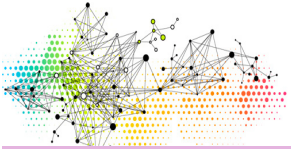
❖ *What is a financial instrument ?*

- Full range of financial contracts made between institutional units.
- Financial instruments are classified as *financial assets* (give rise to financial claims) or as *other financial instruments*.



Definitional Issues

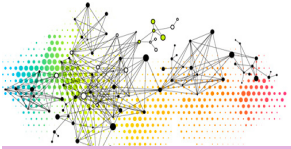
- A ***financial asset*** consist of:
 - Claims on another party, i.e., there is a counterpart liability
 - Distinctive of financial assets from other economic assets, such as land, dwellings, machinery, equipment, etc.
 - Plus, the gold bullion component of monetary gold
 - Due to its role as a means of international payments and store of value for use in reserves.
 - It is not created by an instrument and it does not represent a claim on another entity.



Definitional Issues

❖ *Other financial instruments:*

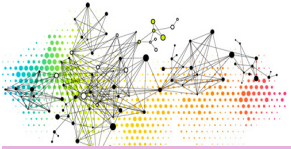
- financial instruments that are not recognized as financial assets: contingent assets and liabilities
- ***Contingent assets*** are not financial assets because they do not give unconditional rise to requirements either to make payments or to provide other objects of value.
- However, by conferring certain rights or obligations that may affect future decisions, they can produce an economic impact on the parties involved.



Definitional Issues

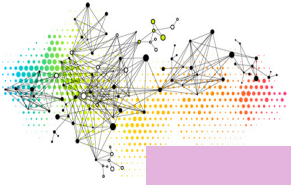
❖ *Examples of contingent assets or liabilities:*

- One-off guarantees of payment by third parties are contingent since payment is only required if the principal debtor defaults.
- Lines of credit, letters of credit, and loan commitments assure that funds will be made available, but no financial asset (i.e., loan) is created until funds are actually advanced.



Classification of Financial Instruments

- Three broad categories of **financial instruments** are used to classify **financial assets** and liabilities:
 - equity and investment fund shares,
 - debt instruments,
 - other financial assets/liabilities.
- This classification is primarily based on the legal characteristics that (i) describe the **underlying relationship** between the parties to an instrument, and (ii) that are also related to **liquidity** and **economic purpose** of the instrument.

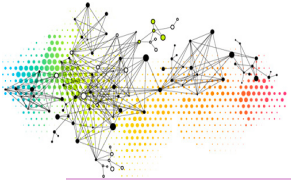


Financial Assets and Liabilities¹

- ***Equity and investment fund shares***
 - Equity
 - Investment fund shares/units
- ***Debt instruments***
 - Special Drawing Rights
 - Currency and deposits²
 - Debt securities
 - Loans
 - Insurance, pension, and standardized guarantee schemes
 - Trade credit and advances
 - Other accounts payable/receivable -other
- ***Other financial assets and liabilities***
 - Monetary gold²
 - Financial derivatives and employee stock options

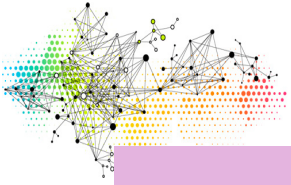
¹ The detailed classification of financial assets and liabilities is harmonized with the *SNA*.

² Gold bullion has no counterpart liability. The counterpart liability of unallocated gold accounts is in deposits.



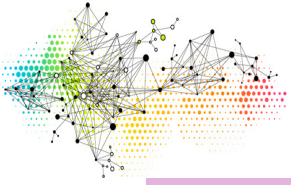
Equity and Investment Fund Shares

- **Equity** comprises all instruments and records that acknowledge 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.
- Investment funds are collective investment undertakings through which investors pool funds for investment in financial and/or nonfinancial assets. These funds raise funds by issuing **shares** (or units/participations). Investment funds include money market funds (MMF) and non-MMF.



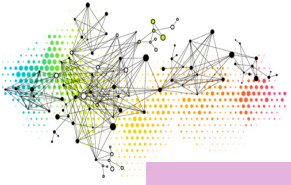
Equity

- ***Equity securities*** comprise *listed and unlisted shares*.
 - ***Listed or quoted shares*** are those listed on an exchange.
 - ***Unlisted shares*** are also called private equity; venture capital also usually takes this form.
- ***Other equity*** (*not mentioned in BPM5*) is equity 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.
 - It could be included in direct investment or in other investment.



Investment Fund Shares: MMFs and Non-MMFs

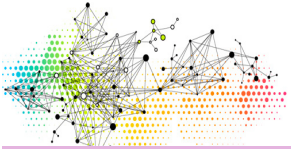
- **Shares** issued by investment (mutual) funds and unit trusts to raise funds. There are 2 type of investment funds:
 - **MMFs** are collective investment schemes that invest only or primarily in money market instruments, (with a residual maturity of less than one year). MMFs shares or units may be regarded as close substitutes for transferable deposits.
 - **Non-MMF** invest predominantly in long-term financial assets and nonfinancial assets (like real estate, commodities). Shares or units issued by non-MMFs are generally not close substitutes for deposits.



Retained Earnings of Investment Funds

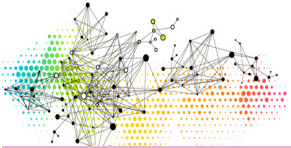
- Investment income attributable to the owners of investment fund shares comprises both ***dividends*** payable and ***retained earnings*** (disregarding whether a direct investment relationship exists).
- Retained earnings of investment funds shares below 10% are separately shown under portfolio investment income.
- This is an important change from *BPM5*, where reinvested earnings were only recorded for direct investment relationships.

Note: Holding gains and losses are never considered as income transactions (recorded as other flows)



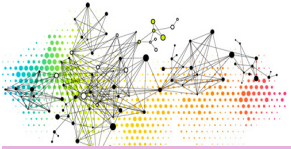
Debt Instruments

- *Debt instruments* are those instruments that require the payment of principal and/or interest at some point(s) in the future.
- Debt instruments comprise:
 - Special Drawing Rights
 - Currency and deposits
 - Debt securities
 - Loans
 - Insurance, Pension, and Standardized Guarantee Schemes
 - Trade credit and advances
 - Other accounts receivable/payable



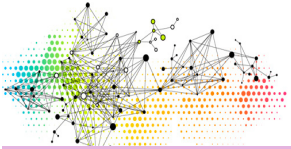
Special Drawing Rights (SDRs)

- **SDRs** are international reserve assets. They represent unconditional rights to obtain foreign exchange or other reserve assets from other IMF members.
- **SDRs** are held only by the monetary authorities of IMF members and a limited number of international financial institutions that are authorized holders.
- **Holdings of SDRs** by an IMF member are recorded as an asset, while the **allocation of SDRs** is recorded as the incurrence of a liability of the member receiving them. This is a change from *BPM5*.
- The holdings and allocations should be shown gross, rather than netted.



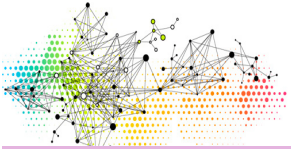
Currency and Deposits

- **Currency** consists of notes and coins that are of fixed nominal values and are issued or authorized by central banks or governments.
- **Deposits** include all claims that are (1) on the central bank, a deposit-taking corporation other than the central bank, and, in some cases, other institutional units; and (2) are represented by evidence of deposit.
- 2 categories of deposits can be distinguished: **transferable deposits** of which interbank deposits, and **other deposits**.



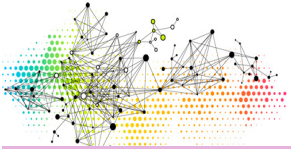
Debt Securities

- ***Debt securities*** are negotiable instruments serving as evidence of a debt.
- Include: bills, bonds, notes, negotiable certificates of deposit, commercial paper, debentures, asset-backed securities, money market instruments and similar instruments normally traded in the financial markets.
- *BPM6* defines some specific debt security instruments such as asset backed securities.



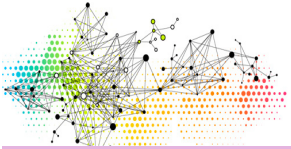
Loans

- **Loans** are financial assets that are created when a creditor lends funds directly to a debtor, and are evidenced by documents that are not negotiable.
- This category includes all loans including overdrafts, e.g. securities repurchase agreements, gold swaps, financial leases. Accounts receivable/payable are treated as a separate category of financial assets.
- Loans that have become debt securities are also excluded from loans (*evidence of secondary market trading, and frequent quotations of the instrument*).



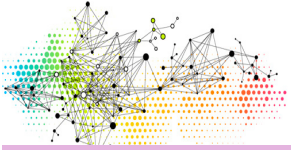
Loans

- 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 or with an open maturity.
- A ***gold swap*** involves an exchange of gold for foreign exchange deposits with an agreement that the transaction be reversed at an agreed future date at an agreed gold price.
 - Margin calls in cash under a repo are also classified as loans.
 - Collateral provided is not registered as a transaction in securities.



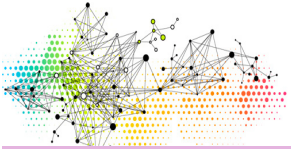
Other Accounts Receivable/Payable

- This (SNA) category comprises two instruments:
- ***Trade credit and advances*** comprises (1) trade credit extended directly by the *suppliers* of goods and services to their customers 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.
- ***Other Accounts Receivable/Payable – other*** includes liabilities for taxes, purchase and sale of securities, securities lending fees, wages and salaries, dividends, and social contributions that have accrued but not yet paid. It also includes prepayments of those items.



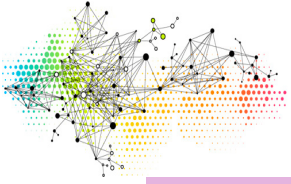
Other Financial Assets and Liabilities

- This category includes:
 - Monetary gold
 - Financial derivatives and employee stock options



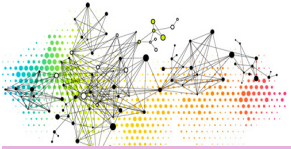
Monetary Gold

- **Gold** to which the monetary authorities (or others who are subject to the effective control of the monetary authorities) have title and that is held as reserve assets.
- It comprises **gold bullion** (including gold held in allocated gold accounts) and **unallocated gold accounts** vis-à-vis nonresidents that give title to claim the delivery of gold.



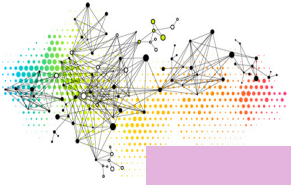
Allocated and Unallocated Gold Accounts

- ***Allocated gold accounts***
 - provide a record of title to specified gold
 - typically offer purchasing, storing, and selling investment grade bars and coin to order
 - full outright ownership of the metal.
- ***Unallocated gold accounts***
 - represent a claim against the account operator to deliver gold
 - accounts through which much of the trading in gold is undertaken in financial markets.



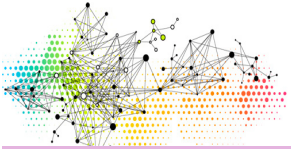
Financial Derivatives

- A financial derivative contract is a financial instrument that is linked to another specific financial instrument, indicator or commodity and through which specific financial risks can be traded in their own right in financial markets.
- Examples of **financial risks** traded: interest rate risk, foreign exchange risk, equity and commodity price risks, credit risk.
- There are two broad categories of financial derivatives:
 - forward type contracts and
 - Options (type).



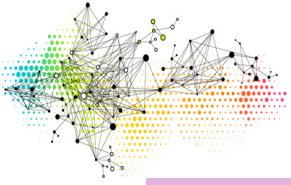
Forward-Type Contracts

- ***A forward-type contract*** is an unconditional contract by which two counterparties agree to exchange a specified quantity of an underlying item (real or financial) at an agreed-upon contract price (the strike price) on a specified date.
- Forward-type contracts include futures, forwards and swaps.
 - Futures are forward-type contracts traded on organized exchanges.
 - Forward rate agreements and forward foreign exchange contracts are common types of forward-type contracts usually traded over the counter (OTC).



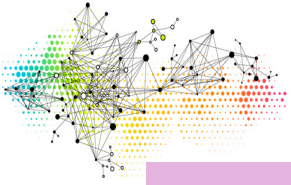
Option Contracts

- In an option contract, **the purchaser** acquires the right but not the obligation to buy (call option) or sell (put option) 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.
- In return, **the writer** acquires the obligation to sell (call option) or buy (put option) a specified underlying item (real or financial) at an agreed-upon contract price (the strike price) on or before a specified date if determined by the buyer of the option.



Summary of Changes in the Treatment of Specific Instruments in *BPM6*

- ***Special Drawing Right (SDR) allocations*** to be classified as a liability.
- So-called ***unallocated gold accounts*** to be classified as a deposit (or monetary gold if held in reserves). ***Gold bullion*** is the only financial asset in the system without a counterpart liability.



Summary of Changes in the Treatment of Specific Instruments in *BPM6*

- ***Arrears*** now recorded as part of the value of the instrument and not as a separate transaction. Arrears related to Exceptional Financing are a memorandum item and are included in the ‘analytical presentation.’
- ***Employee stock options*** to be included in the category, ‘financial derivatives and employee stock options.’
- ***Investment fund shares*** to be separately identified. Money market funds are separately identified as a supplementary item.