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EUROPEAN COMMISSION

Brussels, 20.12.2010  
COM(2010) 774 final  
Annex A/Chapter 05

ANNEX A to the

Proposal for a

**REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**on the European System of national and regional accounts in the European Union**

## ANNEX A

### **CHAPTER 5: FINANCIAL TRANSACTIONS**

#### Definition

- 5.01 Financial transactions (F) are transactions in financial assets (AF) and liabilities between resident institutional units, and between them and non-resident institutional units.
- 5.02 A financial transaction between institutional units is a simultaneous creation or liquidation of a financial asset and the counterpart liability, or a change in ownership of a financial asset, or an assumption of a liability.

#### **GENERAL FEATURES**

##### **Financial assets, financial claims, and liabilities**

#### Definition

- 5.03 Financial assets consist of all financial claims, equity and the gold bullion component of monetary gold.
- 5.04 Financial assets are stores of value representing a benefit or series of benefits accruing to the economic owner by holding or using the assets over a period of time. They are a means of carrying forward values from one accounting period to another. Benefits are settled through payments, which are typically currency (AF.21) and transferable deposits (AF.22).

#### Definition

- 5.05 A financial claim is the right of the creditor to receive a payment or series of payments from the debtor.

Financial claims are financial assets that have corresponding liabilities. Equity and investment fund shares or units (AF.5) is treated as a financial asset with a corresponding liability even though the claim of the holder on the corporation is not a fixed amount.

#### Definition

- 5.06 Liabilities are established when the debtor is obliged to provide a payment or a series of payments to the creditor.
- 5.07 The gold bullion component of monetary gold held by monetary authorities as a reserve asset is treated as a financial asset even though the holder does not have claims on other designated units. There is no matching liability for gold bullion.

## Contingent assets and contingent liabilities

### Definition

5.08 Contingent assets and contingent liabilities are agreements whereby one party is obliged to provide a payment or series of payments to another unit only if certain specific conditions prevail.

As they do not give rise to unconditional obligations, contingent assets and contingent liabilities are not financial assets and liabilities.

5.09 Contingent assets and contingent liabilities include:

- a) One-off guarantees of payment by third parties since payment is only required if the debtor defaults;
- b) Loan commitments providing a guarantee that funds will be made available but no financial asset exists until funds are actually advanced;
- c) Letters of credit which constitute promises to make a payment conditional upon the presentation of certain documents specified by a contract;
- d) Lines of credit which are promises to make loans to a specified customer up to a specified limit.;
- e) Underwritten note issuance facilities (NIFs) providing a guarantee that a potential debtor will be able to sell short-term debt securities known as notes, and that the bank issuing the facility will take up any notes not sold in the market or will provide equivalent advances; and
- f) Pension entitlements under unfunded government defined benefit employer pension schemes or social security pension funds. Such pension entitlements are recorded in the supplementary table on pension schemes in social insurance, and not in the core accounts.

5.10 Contingent assets and contingent liabilities do not include:

- a) Reserves of Insurance, pension and standardised guarantee schemes (AF.6);
- b) Financial derivatives (AF.7) where the arrangements themselves have a market value because they are tradable or can be offset on the market.

5.11 Although contingent assets and contingent liabilities are not recorded in the accounts, they are important for policy and analysis, and information on them needs to be collected and presented as supplementary data. Even though no payments may eventually be due for contingent assets and contingent liabilities, a high level of contingencies may indicate an undesirable level of risk on the part of those units offering them.

### Box 5.1: Treatment of guarantees in the System

#### Definition

B5.1.1. Guarantees are arrangements whereby the guarantor undertakes to a lender that if a borrower defaults, the guarantor will make good the loss the lender would otherwise suffer.

Often a fee is payable for the provision of a guarantee.

B5.1.2. Three different types of guarantees are distinguished. These apply only to guarantees provided in the case of financial assets. No special treatment is proposed for guarantees in the form of manufacturers' warranties or other form of guarantee. The three types of guarantee are as follows:

- a) Guarantees provided by means of a financial derivative, such as a credit default swap. These derivatives are based on the risk of default of reference financial assets and are not linked to individual loans or debt securities.
- b) Standardised guarantees are issued in large numbers, usually for fairly small amounts. Examples are export credit guarantees or student loan guarantees. Even though the probability of any one standardised guarantee being called is uncertain, the fact that there are many similar guarantees means that a reliable estimate of the number of calls under the guarantee can be made. Standardised guarantees are treated as giving rise to financial assets and not contingent assets.
- c) One-off guarantees, where the associated risk cannot be calculated with any degree of accuracy, due to a lack of comparable cases. The granting of a one-off guarantee is considered a contingent asset or a contingent liability and is not recorded as a financial asset or a liability.

### **Categories of financial assets and liabilities**

5.12 Eight categories of financial assets are distinguished:

AF.1 Monetary gold and special drawing rights;

AF.2 Currency and deposits;

AF.3 Debt securities;

AF.4 Loans;

AF.5 Equity and investment fund shares or units;

AF.6 Insurance, pension and standardised guaranteed schemes;

AF.7 Financial derivatives and employee stock options;

AF.8 Other accounts receivable/payable.

5.13 Each financial asset has a counterpart liability, with the exception of the gold bullion component of monetary gold held by monetary authorities as a reserve asset classified in the category monetary gold and special drawing rights. With this exception, eight categories of liabilities are distinguished corresponding to the categories of the counterpart financial assets.

- 5.14 The classification of financial transactions corresponds to the classification of financial assets and liabilities. Eight categories of financial transactions are distinguished:
- F.1 Transactions in monetary gold and special drawing rights
  - F.2 Transactions in currency and deposits;
  - F.3 Transactions in debt securities;
  - F.4 Transactions in loans;
  - F.5 Transactions in equity and investment fund shares or units;
  - F.6 Transactions in insurance, pension and standardised guaranteed schemes;
  - F.7 Transactions in financial derivatives and employee stock options;
  - F.8 Transactions in other accounts receivable/payable.
- 5.15 Because of the symmetry of financial claims and liabilities, the term ‘instrument’ is used to relate to both the asset and the liability aspect of financial transactions. Its use does not imply an extension of the coverage of financial assets and liabilities by including off-balance sheet items which are sometimes described as financial instruments in monetary and financial statistics.

#### **Balance sheets, financial account, and other flows account**

- 5.16 The financial assets held and the liabilities outstanding at a particular point in time are recorded in the balance sheet. Financial transactions result in changes between opening and closing balance sheets. However, changes between the opening balance sheet and the closing balance sheet are also due to other flows, which are not interactions between institutional units by mutual agreement. Other flows related to financial assets and liabilities are broken down into revaluations in financial assets and liabilities, and changes in the volume of financial assets and liabilities not due to financial transactions. Revaluations are recorded in the revaluation account and changes in volume in the other changes in the volume of assets account.
- 5.17 The financial account is the final account in the sequence of accounts that record transactions.. The financial account does not have a balancing item that is carried forward to another account. The balancing item of the financial account, the net acquisitions of financial assets less net incurrence of liabilities, is net lending (+) or net borrowing (-) (B.9F).
- 5.18 The balancing item of the financial account is conceptually identical with the balancing item of the capital account.. In practice, a discrepancy will usually be found between them because they are calculated on the basis of different statistical data.

## Valuation

- 5.19 Financial transactions are recorded at transaction values, that is, the values in national currency at which the financial assets and/or liabilities involved are created, liquidated, exchanged or assumed between institutional units, on the basis of commercial considerations.
- 5.20 Financial transactions and their financial or non-financial counterpart transactions are recorded at the same transaction value. There are three possibilities:
- a) The financial transaction gives rise to a payment in national currency: the transaction value is equal to the amount exchanged;
  - b) The financial transaction is a transaction in foreign currency and the counterpart transaction is not a transaction in national currency: the transaction value is equal to the amount in national currency at the market rate prevailing when the payment takes place; and
  - c) Neither the financial transaction nor its counterpart transaction is a transaction in cash or other means of payment: the transaction value is the current market value of the financial assets and/or liabilities involved.
- 5.21 The transaction value refers to a specific financial transaction and its counterpart transaction. In concept, the transaction value is to be distinguished from a value based on a price quoted in the market, a fair market price, or any price that is intended to express the generality of prices for a class of similar financial assets and/or liabilities. However, in cases where the counterpart transaction of a financial transaction is, for example, a transfer and therefore the financial transaction may be undertaken other than for purely commercial considerations, the transaction value is identified with the current market value of the financial assets and/or liabilities involved.
- 5.22 The transaction value does not include service charges, fees, commissions, and similar payments for services provided in carrying out the transactions; these are to be recorded as payments for services. Taxes on financial transactions are also excluded and are treated as taxes on services within taxes on products. When a financial transaction involves a new issue of liabilities, the transaction value is equal to the amount of the liability incurred excluding any prepaid interest. Similarly, when a liability is extinguished, the transaction value for both creditor and debtor must correspond to the reduction of the liability.

## Net and gross recording

### Definition

- 5.23 Net recording of financial transactions means that acquisitions of financial assets are shown net of disposals of financial assets, and that incurrences of liabilities are shown net of repayments of liabilities.

Financial transactions may be represented net across financial assets with different characteristics and with different debtors or creditors, provided they are within the same category or sub-category.

## Definition

- 5.24 Gross recording of financial transactions means that acquisitions and disposals of financial assets are shown separately, as are incurrences and repayments of liabilities.

Gross recording of financial transactions shows the same amount of net lending and net borrowing as if financial transactions were recorded net.

Financial transactions are to be recorded gross in cases of detailed financial market analyses.

## Consolidation

### Definition

- 5.25 Consolidation in the financial account refers to the process of offsetting transactions in financial assets for a given group of institutional units against the counterpart transactions in liabilities for the same group of institutional units.

Consolidation can be performed at the level of the total economy, of institutional sectors, and of sub-sectors. The financial account of the rest of the world is consolidated by definition since only transactions of the non-resident institutional units with resident institutional units are recorded.

- 5.26 Different levels of consolidation are appropriate for different types of analysis. For example, consolidation of the financial account for the total economy emphasises the economy's financial transactions with non-resident institutional units since all financial transactions between resident institutional units are netted on consolidation. Consolidation for sectors permits the tracing of overall financial transactions between sectors with net lending and those with net borrowing. Consolidation at the sub-sector level for financial corporations can provide much more detail on financial intermediation and allow, for example, the identification of the monetary financial institutions' transactions with other financial corporations as well as with other resident sectors and with non-resident institutional units. Another area where consolidation can be instructive at the sub-sector level is within the general government sector, since transactions between the various levels of government are retained.

- 5.27 As a rule, the accounting entries in the System are not consolidated, as a consolidated financial account requires information on the counterpart grouping of institutional units. This requires financial transaction data on a from-whom-to-whom basis. For example, the compilation of consolidated general government liabilities requires a distinction to be made, among the holders of general government liabilities, between general government and other institutional units.

## Netting

### Definition

- 5.28 Netting is the consolidation at the level of a single institutional unit whereby accounting entries on both sides of the account for the same transaction item are offset against one another. Netting is to be avoided unless source data are lacking.



- 5.29 Various degrees of netting can be distinguished as transactions in liabilities are subtracted from transactions in financial assets for the same financial asset category or sub-category.
- 5.30 When a department of an institutional unit purchases bonds issued by another department of the same institutional unit, the financial account of the unit does not record the transaction as the acquisition of a claim by one department on another. The transaction is recorded as a redemption of liabilities rather than an acquisition of consolidating assets. Such financial instruments are viewed as netted. Netting is to be avoided if it is necessary to keep the financial instrument on both the asset side and the liability side to follow the legal presentation.
- 5.31 Netting may be unavoidable for transactions of an institutional unit in financial derivatives, where separate data on transactions in assets and liabilities are usually not available. It is appropriate to net these transactions because the value of a position in financial derivatives may switch sign, i.e. to change from an asset to a liability position, as the value of the instrument ‘underlying’ the derivative contract changes in relation to the price in the contract .

#### **Accounting rules for financial transactions**

- 5.32 Quadruple-entry is an accounting practice in which each transaction involving two institutional units is recorded twice by each unit. For example businesses exchanging of goods for cash will result in entries in both the production account and the financial account for each unit. Quadruple-entry accounting ensures symmetry of reporting by the institutional units involved, and so consistency in the accounts.
- 5.33 A financial transaction always has a counterpart transaction. This counterpart may be another financial transaction or a non-financial transaction.
- 5.34 Where a transaction and its counterpart are both financial transactions, they change the portfolio of financial assets and liabilities and they may change the totals of both financial assets and liabilities of the institutional units, but they do not change net lending/net borrowing or net worth.
- 5.35 The counterpart of a financial transaction may be a non-financial transaction such as a transaction in products, a distributive transaction, or a transaction in non-financial non-produced assets. Where the counterpart transaction of a financial transaction is not a financial transaction, net lending/ net borrowing of the institutional units will change.

#### **A financial transaction with a current or a capital transfer as counterpart**

- 5.36 The counterpart transaction of a financial transaction may be a transfer. In this case, the financial transaction involves a change in ownership of a financial asset, or an assumption of a liability as debtor, known as debt assumption, or the simultaneous liquidation of a financial asset and the counterpart liability, known as debt cancellation or debt forgiveness. Debt assumption and debt cancellation are capital transfers (D.9) and recorded in the capital account.
- 5.37 If the owner of a quasi-corporation assumes liabilities from or cancels financial claims against the quasi-corporation, the counterpart transaction of debt assumption

or debt cancellation is a transaction in equity (F.51). An exception is if the operation is intended to cover accumulated losses or an exceptionally large loss, or is made in the context of persistent losses, in which cases the operation is classified as a non-financial transaction – a capital transfer or a current transfer.

- 5.38 If government cancels or assumes debt from a public corporation which disappears as an institutional unit in the system, no transaction is recorded in the capital account or the financial account. In this case a flow is recorded in the other changes in the volume of assets account.
- 5.39 If government cancels or assumes debt from a public corporation as part of a process of privatisation to be achieved in the short term, the counterpart transaction is a transaction in equity (F.51) up to the total of privatisation receipts. In other words, the government, by cancelling or assuming debt of the public corporation, is considered to be temporarily increasing its equity in the corporation. Privatisation means the giving up of control over that public corporation by the disposal of equity. Such a cancellation of debt or debt assumption leads to an increase of the own funds of the public corporation, even in the absence of an issue of equity.
- 5.40 The writing-off or writing-down of bad debts by creditors and the unilateral cancellation of a liability by a debtor, known as debt repudiation, are not transactions because they do not involve interactions between institutional units by mutual agreement. The writing-off or writing-down of bad debts by creditors is recorded in the other changes in the volume of assets account.

#### **A financial transaction with property income as counterpart**

- 5.41 The counterpart transaction of a financial transaction may be property income.
- 5.42 Interest (D.41) is receivable by creditors and payable by debtors of certain kinds of financial claims classified in the categories monetary gold and special drawing rights, currency and deposits (AF.2), debt securities (AF.3), loans (AF.4) and other accounts receivable/payable (AF.8).
- 5.43 Interest is recorded as accruing continuously over time to the creditor on the amount of principal outstanding. The counterpart transaction of an entry in interest (D.41) is a financial transaction creating a financial claim of the creditor against the debtor. The accumulation of interest is recorded in the financial account with the financial instrument to which it relates. The effect of this financial transaction is that interest is reinvested. The actual payment of interest is not recorded as interest (D.41), but as a transaction in currency and deposits (F.2) matched by an equivalent repayment of the relevant asset reducing the net financial claim of the creditor against the debtor.
- 5.44 When accrued interest is not paid when due, it gives rise to interest arrears. As it is the accrued interest which is recorded, interest arrears do not change the total of financial assets or liabilities.
- 5.45 Income of corporations comprises dividends (D.421), withdrawals of income from quasi-corporations (D.422), reinvested earnings on foreign direct investment, (D.43) and retained earnings of domestic enterprises. The effect of the counterpart financial transaction in the case of reinvested earnings is that the property income is reinvested in the direct investment enterprise.

- 5.46 Dividends are recorded as investment income at the time the shares start to be quoted ex-dividend. This also applies to withdrawals of income from quasi-corporations. A different recording is made for extraordinarily large dividends or withdrawals that are out of line with recent experience of the amount of income available for distribution to the owners of the corporation. Such excess distribution is recorded as a withdrawal of equity in the financial account and not as investment income.
- 5.47 Property income receivable by investment funds, net of a part of management costs, and assigned to shareholders, even though it is not distributed, is recorded in property income with a counterpart entry in the financial account under investment fund shares or units. The effect is that the income assigned to shareholders but not distributed is treated as reinvested in the fund.
- 5.48 Investment income is attributed to insurance policy holders (D.44), holders of pension entitlements, and holders of investment fund shares. Regardless of the amount actually distributed by the insurance corporation, pension fund or investment fund, the full amount of investment income received by the insurance corporation or fund is recorded as distributed to the policy holders or holders of shares. The amount not actually distributed is recorded in the financial account as reinvestment.

### **Time of recording**

- 5.49 Financial transactions and their counterpart transactions are recorded at the same point in time.
- 5.50 When the counterpart of a financial transaction is a non-financial transaction, both are recorded at the time the non-financial transaction takes place. For example, when sales of goods or services give rise to a trade credit, this financial transaction is to be recorded when the entries are made in the relevant non-financial account, when the ownership of the goods is transferred or when the service is provided.
- 5.51 When the counterpart of a financial transaction is a financial transaction, there are three possibilities:
- a) Both financial transactions are transactions in cash or other means of payment: they are recorded at the time the first payment is made;
  - b) Only one of the two financial transactions is a transaction in cash or other means of payment: they are recorded at the time payment is made; and
  - c) Neither of the two financial transactions is a transaction in cash or other means of payment: they are recorded at the time the first financial transaction takes place.

### **A from-whom-to-whom financial account**

- 5.52 The from-whom-to-whom financial account or the financial account by debtor/creditor is an extension of the non-consolidated financial account. It is a three dimensional presentation of financial transactions where both parties to a transaction are shown, as well as the nature of the financial instrument being transacted.

This presentation provides information on debtor/ creditor relationships and is consistent with a from-whom-to-whom financial balance sheet. No information is provided on the institutional units to whom financial assets were sold or from whom financial assets were bought. This also applies to corresponding transactions in liabilities. The from-whom-to-whom financial account is also known as the flow of funds matrix.

- 5.53 Based on the principle of quadruple-entry accounting a from-whom-to-whom financial account has three dimensions: the financial instrument category, the sector of the debtor, and the sector of the creditor. A from-whom-to-whom financial account requires three-dimensional tables covering the breakdowns by financial instrument, debtor and creditor. Such tables show the financial transactions cross-classified by debtor sector and creditor sector as shown in Table 5.1.
- 5.54 The table for the financial instrument category debt securities shows that, as a result of transactions in the reference period, the debt securities acquired, net of disposals, by households and by non-profit institutions serving households (275) represent claims on non-financial corporations (65), financial corporations (43), general government (124), and the rest of the world (43). The table shows that, as a result of transactions in the reference period, non-financial corporations incurred, net of redemptions, liabilities in the form of debt securities of 147: their liabilities in this form to other non-financial corporations increased by 30, to financial corporations by 23, to general government by 5, to households and non-profit institutions serving households by 65 and to the rest of the world by 24. No debt securities were issued by households and non-profit institutions serving households. Because of the consolidated presentation of the rest of the world, no transactions are shown between non-resident institutional units. Similar tables can be compiled for all financial instrument categories.

**Table 5.1: A from-whom-to-whom financial account for debt securities**

Debtor sector \ Creditor sector		Net incurrence of debt securities by						
		Non-financial corporations	Financial corporations	General government	Households and non-profit institutions serving households	National economy	Rest of the world	Total
Net acquisition of debt securities by	Non-financial corporations	30	11	67		108	34	<b>142</b>
	Financial corporations	23	22	25		70	12	<b>82</b>
	General government	5	2	6		13	19	<b>32</b>
	Households and non-profit institutions serving households	65	43	124		232	43	<b>275</b>
	National economy	123	78	222		423	108	<b>531</b>
	Rest of the world	24	28	54		106		<b>106</b>
	<b>Total</b>	<b>147</b>	<b>106</b>	<b>276</b>		<b>529</b>	<b>108</b>	<b>637</b>

- 5.55 The from-whom-to-whom financial account allows analysis of who is financing whom, to what amount and by which financial asset. It provides the answers to questions such as:
- a) What are the counterpart sectors of the financial assets acquired net or of the liabilities incurred net by an institutional sector?
  - b) Which are the corporations with which the general government sector participates?
  - c) What amounts of debt securities do resident sectors and the rest of the world acquire (net of disposals), which have been issued (net of redemptions) by general government, financial or non-financial corporations, and the rest of the world?

## **CLASSIFICATION OF FINANCIAL TRANSACTIONS BY CATEGORIES IN DETAIL**

The following definitions and descriptions are of financial instruments. When a transaction is being recorded, the code used is F. When the underlying stock level or position of an asset or liability is being recorded, then the coding is AF.

### **Monetary gold and special drawing rights (F.1)**

- 5.56 The category monetary gold and special drawing rights (SDRs) (F.1) consists of two sub-categories:
- a) Monetary gold (F.11); and
  - b) Special drawing rights (SDRs) (F.12).

#### *Monetary gold (F.11)*

##### Definition

- 5.57 Monetary gold is gold to which monetary authorities have title and which is held in reserve assets.

It includes gold bullion, and unallocated gold accounts with non-residents that give title to claim the delivery of gold.

- 5.58 Monetary authorities include the central bank and central government institutions which carry out operations usually attributed to the central bank. Such operations include the issue of currency, maintenance and management of reserve assets and the operation of exchange stabilisation funds.

- 5.59 Subject to the effective control of the monetary authorities means that:

- a) The resident entities can transact in these claims with non-residents only on the terms specified by the monetary authorities or with their express approval; and

- b) The monetary authorities have access on demand to these claims on non-residents to meet balance of payments financing needs and other related purposes; and
  - c) There is a prior law or other binding arrangement confirming this agency role of the resident.
- 5.60 All monetary gold is included in reserve assets or is held by international financial organisations. Its components are
- a) Gold bullion (including monetary gold held in allocated gold accounts); and
  - b) Unallocated gold accounts with non-residents.
- 5.61 Gold bullion included in monetary gold is the only financial asset for which there is no counterpart liability. It takes the form of coins, ingots, or bars with a purity of at least 995 parts per 1000. Gold bullion not held as reserve assets is a non-financial asset and is included in non-monetary gold.
- 5.62 Allocated gold accounts provide ownership of a specific piece of gold. The ownership of the gold remains with the entity placing it for safe custody. These accounts typically offer purchasing, storing, and selling facilities. When held as reserve assets, allocated gold accounts are classified as monetary gold, and so as a financial asset. When not held as reserve assets, allocated gold accounts represent ownership of a commodity, namely non-monetary gold.
- 5.63 In contrast to allocated gold accounts, unallocated gold accounts represent a claim against the account operator to deliver gold. When held as reserve assets, unallocated gold accounts are classified as monetary gold, and so as a financial asset. Unallocated gold accounts not held as reserve assets are classified as deposits.
- 5.64 Transactions in monetary gold consist predominantly of purchases and sales of monetary gold among monetary authorities or certain international financial organisations. There cannot be any transactions in monetary gold involving institutional units other than those. Purchases of monetary gold are recorded in the financial accounts of monetary authorities as an increase in financial assets and sales are recorded as a decrease in financial assets. The counterpart entries are recorded respectively as a decrease in financial assets or an increase in financial assets of the rest of the world.
- 5.65 If monetary authorities add non-monetary gold to their holdings of monetary gold (for example, by purchasing gold in the market), or release monetary gold from their holdings for non-monetary purposes (for example, by selling it in the market), they are deemed to have monetised or demonetised gold, respectively. Monetisation or demonetisation of gold does not give rise to entries in the financial account, but to entries in the other changes in the volume of assets account as a change in classification of assets and liabilities, i.e. the reclassification of gold from a valuable (AN.13) to monetary gold. (AF.11) (Paragraph 6.22-6.24). Demonetisation of gold is reclassification of monetary gold to a valuable.
- 5.66 Deposits, loans, and securities denominated in gold are treated as financial assets other than monetary gold and are classified along with similar financial assets in

foreign currency in the appropriate category. Gold swaps are forms of securities repurchase agreements (repos) involving either monetary gold or non-monetary gold. They imply the exchange of gold for a deposit with an agreement that the transaction will be reversed at an agreed future date at an agreed gold price. Following the general practice for the recording of reverse transactions, the gold taker will not record the gold on its balance sheet, while the gold provider will not remove the gold from its balance sheet. Gold swaps are recorded as collateralised loans by both parties, where the collateral is gold. Monetary gold swaps are undertaken between monetary authorities or between monetary authorities and other parties, while non-monetary gold swaps are similar transactions without the involvement of monetary authorities.

- 5.67 Gold loans consist of the delivery of gold for a given time period. As for other reverse transactions, legal ownership of the gold is transferred, but the risks and benefits of changes in the gold price remain with the lender. Gold borrowers often use these transactions to cover their sales to third parties in periods of gold shortage. A fee, determined by the value of the underlying asset and the duration of the reverse transaction, is paid to the original owner for the use of the gold.
- 5.68 Monetary gold is a financial asset; the fees for gold loans are accordingly payments for putting a financial asset at the disposal of another institutional unit. Fees associated with loans of monetary gold are treated as interest. This also applies as a simplifying convention to fees paid on loans of non-monetary gold.

#### *SDRs (F.12)*

##### Definition

- 5.69 SDRs are international reserve assets created by the International Monetary Fund (IMF) and which are allocated to its members to supplement existing reserve assets.
- 5.70 The SDR Department of the IMF manages reserve assets by allocating SDRs among member countries of the IMF and certain international agencies, known collectively known as the participants.
- 5.71 The creation of SDRs through their allocation, and extinguishing through their cancellations, are transactions. Allocations of SDRs are recorded gross as acquisition of an asset in the financial accounts of the monetary authorities of the individual participant, and as an incurrence of a liability by the rest of the world.
- 5.72 SDRs are held exclusively by official holders, which are central banks and certain international agencies, and are transferable among participants and other official holders. SDR holdings represent each holder's assured and unconditional right to obtain other reserve assets, especially foreign exchange, from other IMF members.
- 5.73 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 other reserve assets, particularly foreign exchange, in return.

## Currency and deposits (F.2)

### Definition

5.74 Currency and deposits are currency in circulation and deposits, both in national currency and in foreign currencies.

5.75 There are three sub-categories of financial transactions:

- a) Currency (F.21);
- b) Transferable deposits (F.22); and
- c) Other deposits (F.29).

### *Currency (F.21)*

#### Definition

5.76 Currency is notes and coins that are issued or authorised by monetary authorities.

5.77 Currency includes:

- a) Notes and coins issued by the resident monetary authorities as national currency in circulation held by residents and non-residents; and
- b) Notes and coins issued by non-resident monetary authorities as foreign currencies in circulation and held by residents.

5.78 Currency does not include:

- a) Notes and coins that are not in circulation, for example, a central bank's stock of its own notes or emergency stockpiles of notes; and
- b) Commemorative coins that are not commonly used to make payments. They are classified as valuables.

### Box 5.2: Currency issued by the Eurosystem

B.5.2.1 Euro banknotes and coins issued by the Eurosystem are the domestic currency of the EU Member States in the euro area. Although treated as domestic currency, holdings of euro currency by residents of each participating Member State are liabilities of the resident national central bank only to the extent of its notional share in the total issue, based on its share in the capital of the ECB. A consequence is that, in the euro area, from a national perspective, part of residents' holdings of domestic currency may be a financial claim on non-residents.

B.5.2.2. Currency issued by the Eurosystem covers notes and coins. Notes are issued by the Eurosystem; coins are issued by central governments in the euro area, though by convention they are treated as liabilities of the national central banks which as counterpart hold a notional claim on general government. Euro banknotes and coins may be held by euro area residents or by non-residents of the euro area.



### *Deposits (F.22 and (F.29)*

#### Definition

5.79 Deposits are standardised, non-negotiable contracts with the public at large, offered by deposit-taking corporations and, in some cases, by central government as debtors, and allowing the placement and the later withdrawal of the principal amount by the creditor. Deposits usually involve the debtor giving back the full principal amount to the investor.

### *Transferable deposits (F.22)*

#### Definition

5.80 Transferable deposits are deposits exchangeable for currency on demand at par and which are directly usable for making payments by cheque, draft, giro order, direct debit/credit, or other direct payment facility, without penalty or restriction.

5.81 Transferable deposits predominantly represent liabilities of resident deposit-taking corporations, in some cases of central government, and of non-resident institutional units. Transferable deposits includes:

- a) Inter-bank positions between monetary financial institutions;
- b) Deposits held with the central bank by deposit-taking corporations in excess of the amount of reserves that they are obliged to hold, and which they are able to use without notice or restriction;
- c) Deposits which other monetary financial institutions incur vis-à-vis the central bank in the form of unallocated gold accounts which are not monetary gold, and also corresponding deposits in the form of precious metal accounts;
- d) Foreign currency deposits under swap arrangements; and
- e) The reserve position with the IMF forming the ‘reserve tranche’, that is the SDR or foreign currency amounts that a member country may draw from the IMF at short notice, and other claims on the IMF that are readily available to the member country including the reporting country’s lending to the IMF under the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB).

5.82 Transferable deposits accounts may have overdraft facilities. If the account is overdrawn, the withdrawal to zero is withdrawal of a deposit, and the amount of the overdraft is the granting of a loan.

5.83 All resident sectors and the rest of the world may hold transferable deposits.

5.84 Transferable deposits may be divided by currency into transferable deposits denominated in domestic currency and in foreign currencies.

### *Other deposits (F.29)*

#### Definition

5.85 Other deposits are deposits other than transferable deposits. Other deposits cannot be used to make payments except on maturity or after an agreed period of notice, and they are not exchangeable for currency or for transferable deposits without some significant restriction or penalty.

5.86 Other deposits include:

- a) Time deposits, which are deposits not immediately disposable, but disposable with an agreed maturity. Their availability is subject to a fixed term or they are redeemable at notice of withdrawal. They also include deposits with the central bank held by deposit-taking corporations as compulsory reserves to the extent that the depositors cannot use them without notice or restriction;
- b) Savings deposits, savings books, non-negotiable savings certificates or non-negotiable certificates of deposit;
- c) Deposits resulting from a savings scheme or contract. These deposits often involve an obligation on the part of the depositor to make regular payments over a given period, and the capital paid and interest accrued do not become available until a fixed term has elapsed. These deposits are sometimes combined with the issue, at the end of the savings period, of loans which are proportionate to the accumulated savings, for the purpose of buying or building a dwelling;
- d) Evidence of deposit issued by savings and loan associations, building societies, credit unions, and the like, sometimes called shares, which are redeemable on demand or at relatively short notice, but which are not transferable;
- e) Repayable margin payments related to financial derivatives which are liabilities of monetary financial institutions;
- f) Short-term repurchase agreements (repos) which are liabilities of monetary financial institutions; and
- g) Liabilities to the IMF that are components of international reserves and are not evidenced by loans; they consist of use of Fund credit within the IMF's General Resources Account; this item measures the amount of a member's currency with the IMF that the member is obligated to repurchase.

5.87 Other deposits do not include negotiable certificates of deposit and negotiable savings certificates. They are classified under debt securities (AF.3).

5.88 Other deposits may be divided by currency into other deposits denominated in domestic currency and other deposits denominated in foreign currencies.

### **Debt securities (F.3)**

#### Definition

5.89 Debt securities are negotiable financial instruments serving as evidence of debt.

### *Main features of debt securities*

5.90 Debt securities display the following characteristics:

- a) An issue date on which the debt security is issued;
- b) An issue price at which investors buy the debt securities when first issued;
- c) A redemption date or maturity date, on which the final contractually scheduled repayment of the principal is due;
- d) A redemption price or face value, which is the amount to be paid by the issuer to the holder at maturity;
- e) An original maturity, which is the period from the issue date until the final contractually scheduled payment;
- f) A remaining or residual maturity, which is the period from the reference date until the final contractually scheduled payment;
- g) A coupon rate that the issuer pays to holders of the debt securities; the coupon may be fixed throughout the life of the debt security or vary with inflation, interest rates, or asset prices. Bills and zero-coupon debt securities offer no coupon interest;
- h) Coupon dates, on which the issuer pays the coupon to the securities' holders;
- i) The issue price, redemption price, and coupon rate may be denominated (or settled) in either national currency or foreign currencies; and
- j) The credit rating of debt securities, which assesses the credit worthiness of individual debt securities issues. Rating categories are assigned by recognised agencies.

With regard to category c) above, the maturity date may coincide with the conversion of a debt security into a share. In this context, convertibility means that the holder may exchange a debt security for the issuer's common equity. Exchangeability means that the holder may exchange the debt security for shares of a corporation other than the issuer. Perpetual securities, which have no stated maturity date, are classified as debt securities.

5.91 Debt securities includes financial assets and liabilities which may be described according to different classifications – by maturity, holding and issuing sector and sub-sector, currency, and type of interest rate.

#### **Classification by original maturity and currency**

5.92 Transactions in debt securities are divided by original maturity into two sub-categories:

- a) Short-term debt securities (F.31); and
- b) Long-term debt securities (F.32).

- 5.93 Debt securities may be denominated in national currency or in foreign currencies. A further breakdown of debt securities denominated in various foreign currencies may be appropriate and will vary depending on the relative importance of the individual foreign currencies for an economy.
- 5.94 Debt securities with both principal and coupon linked to a foreign currency are classified as denominated in that foreign currency.

### **Classification by type of interest rate**

- 5.95 Debt securities may be classified by type of interest rate. Three groups of debt securities are distinguished:
- a) Fixed interest rate debt securities;
  - b) Variable interest rate debt securities; and
  - c) Mixed interest rate debt securities.

### **Fixed interest rate debt securities**

- 5.56 Fixed interest rate debt securities cover:
- a) Plain debt securities, which are issued and redeemed at par value;
  - b) Debt securities issued at discount or at premium to their par value. Examples are treasury bills, commercial paper, promissory notes, bill acceptances, bill endorsements, and certificates of deposit;
  - c) Deep discounted bonds having small interest payments and issued at a considerable discount to par value;
  - d) Zero-coupon bonds, which are single-payment debt securities with no coupon payments. The bond is sold at a discount from par value, and the principal is repaid at maturity or sometimes redeemed in tranches. Zero-coupon bonds may be created from fixed rate debt securities by ‘stripping off’ the coupons, that is, by separating the coupons from the final principal payment of the security and trading them independently;
  - e) Separate Trading of Registered Interest and Principal Securities (STRIPS), or stripped debt securities, which are securities whose interest and principal payment portions have been separated, or ‘stripped’, and may then be sold separately;
  - f) Perpetual, callable, and puttable debt securities, and debt securities with sinking fund provision;
  - g) Convertible bonds, which may, at the option of the holder, be converted into the equity of the issuer, at which point they are classified as shares; and
  - h) Exchangeable bonds, with an embedded option to exchange the security for a share in a corporation other than the issuer, usually a subsidiary or company in which the issuer owns a stake, at some future date and under agreed conditions.

5.97 Fixed interest rate debt securities also include other debt securities like equity warrant bonds, subordinated bonds, non-participating preference shares that pay a fixed income but do not provide for participation in the distribution of the residual value of a corporation on dissolution, and stapled instruments.

#### **Variable interest rate debt securities**

5.98 Variable interest rate debt securities have their interest and/or principal payments linked to:

- a) A general price index for goods and services (such as the consumer price index);
- b) An interest rate; or
- c) An asset price.

5.99 Variable interest rate debt securities are usually classified as long-term debt securities, unless they have an original maturity of one year or less.

5.100 Inflation linked and asset price linked debt securities include those debt securities issued as inflation-linked bonds and as commodity-linked bonds. The coupons and/or the redemption value of a commodity-linked bond are linked to the price of a commodity. Debt securities, interest on which is linked to the credit rating of another borrower, are classified as index-linked debt securities, as credit ratings do not change in a continuous manner in response to market conditions.

5.101 For interest rate linked debt securities, the contractual nominal interest and/or the redemption value are variable in terms of national currency. At the date of issue, the issuer cannot know the value of interest and principal repayments.

#### **Mixed interest rate debt securities**

5.102 Mixed interest rate debt securities have both a fixed and a variable coupon rate over their life and are classified as variable interest rate debt securities. They cover debt securities that have:

- a) A fixed coupon and a variable coupon at the same time;
- b) A fixed or a variable coupon until a reference point and then a variable or a fixed coupon from that reference point to the maturity date; or
- c) Coupon payments that are pre-fixed over the life of the debt securities, but are not constant over time. They are called stepped debt securities.

#### **Private placements**

5.103 Debt securities also include private placements. Private placements involve an issuer selling debt securities directly to a small number of investors. The credit worthiness of the issuers of these debt securities are typically not assessed by credit rating agencies, and the securities are generally not resold or re-priced, so the secondary

market is shallow. However, most private placements meet the criterion of negotiability and are classified as debt securities.

## Securitisation

### Definition

- 5.104 Securitisation is the issuance of debt securities for which coupon or principal payments are backed by specified assets or by future income streams. A variety of assets or future income streams may be securitised including, among others, residential and commercial mortgage loans; consumer loans; corporate loans, government loans; insurance contracts; credit derivatives; and future revenue.
- 5.105 Securitisation of assets or of future income streams has been an important financial innovation that has led to the creation and extensive use of new financial corporations to facilitate the creation, marketing, and issuance of debt securities. Securitisation has been driven by different considerations. For corporations these include: cheaper funding than available through banking facilities; the reduction in regulatory capital requirements; the transfer of various types of risk like credit risk or insurance risk, and the diversification of funding sources.
- 5.106 Securitisation schemes vary within and across debt securities markets. These schemes can be grouped into three broad types:
- a)
  - b) A financial corporation engaging in the securitisation of assets and a transfer of the assets providing collateral from the original holder, known as a true-sale; and
  - c) Securitisation schemes involving a financial corporation engaged in the securitisation of assets and a transfer of credit risk only, using credit default swaps (CDS) – the original owner retains the assets, but passes on the credit risk. This is known as synthetic securitisation.
- 5.107 Referring to securitisation scheme (a), a securitisation corporation is created to hold securitised assets or other assets that have been removed from the balance sheet of the original holder, and issue debt securities collateralised by these assets.
- 5.108 It is essential to establish whether the financial corporation engaged in the securitisation of assets actively manages its portfolio by issuing debt securities and bearing risk, rather than simply acting as a trust that passively manages assets or holds debt securities. When the financial corporation is the legal owner of a portfolio of assets, issues debt securities that present an interest in the portfolio, has a full set of accounts, and bears market and credit risks, it is acting as a financial intermediary classified in other financial intermediaries. Financial corporations engaged in the securitisation of assets, also called financial vehicle corporations (FVC), usually don't bear the market or the credit risk, since any change in the value of the assets they hold due to those risks is compensated on a one-to-one basis by a decrease in the principal and/or interest to be paid to the holders of the asset-backed securities (ABS). Credit rating agencies also insist that the securitisation corporations are completely insolvency-proof. Financial corporations engaged in the securitisation of

assets are distinguished from entities that are created solely to hold specific portfolios of financial assets and liabilities. These entities are combined with their parent corporation, if resident in the same country as the parent. However, as non-resident entities they are treated as separate institutional units and are classified as captive financial institutions.

5.109 In securitisation scheme (b), the original owner of the assets, or protection buyer, by means of credit default swaps (CDS), transfers the credit risk related to a pool of diversified reference assets to a securitisation corporation but retains the assets themselves. The proceeds from the issue of debt securities are placed in a deposit or into another safe investment such as AAA bonds, and the interest accrued on the deposit, together with the premium from the CDS, finances the interest on the debt securities issued. If a default occurs, the principal owed to the holders of the ABS is reduced – with junior tranches getting the first ‘hit’, etc. Coupon and principal payments may also be re-directed to the original collateral owner from investors in the debt securities to cover default losses.

5.110 An asset-backed security (ABS) is a debt security whose principal and/or interest is solely payable from the cash flows produced by a specified pool of financial or non-financial assets.

5.111 Covered bonds are debt securities issued by a financial corporation, or fully guaranteed by a financial corporation. In case of default of the issuing or guarantor financial corporation, bond holders have a priority claim on the cover pool, in addition to their ordinary claim on the financial corporation.

## **Loans (F.4)**

### Definition

5.112 Loans are created when creditors lend funds to debtors.

### *Main features of loans*

5.113 Loans are characterised by the following features:

- a) The conditions governing a loan are either fixed by the financial corporation granting the loan or agreed by the lender and the borrower directly or through a broker;
- b) The initiative to take out a loan normally lies with the borrower; and
- c) A loan is an unconditional debt to the creditor which has to be repaid at maturity and which is interest-bearing.

5.114 Loans can be financial assets or liabilities of all resident sectors and the rest of the world. Deposit taking corporations normally record short-term liabilities as deposits, not as loans.

### *Classification of loans by original maturity, currency, and purpose of lending*

5.115 Transactions in loans can be categorised into two types by original maturity:

- a) Short-term loans with a short-term original maturity, including loans repayable on demand (F.41); and
- b) Long-term loans with a long-term original maturity (F.42).

5.116 It can be analytically useful to sub-categorise loans further as follows:

- a) Loans denominated in national currency; and
- b) Loans denominated in foreign currencies.

For households, a useful sub-categorisation is as follows:

- a) Loans for consumption;
- b) Loans for house purchase; and
- c) Other loans.

### *Distinction between transactions in loans and transactions in deposits*

5.117 The distinction between transactions in loans (F.4) and transactions in deposits (F.22) is that a debtor offers a standardised non-negotiable contract in the case of a loan, but not in the case of a deposit.



- 5.118 Short-term loans granted to deposit taking corporations, are classified as transferable deposits or as other deposits, and short-term loans accepted by institutional units other than deposit taking corporations, are classified as short-term loans.
- 5.119 Placements of funds between deposit taking corporations are always recorded as deposits.

*Distinction between transactions in loans and transactions in debt securities*

- 5.120 The distinction between transactions in loans (F.4) and transactions in debt securities (F.3) is that loans are non-negotiable financial instruments while debt securities are negotiable financial instruments.
- 5.121 In most cases, loans are evidenced by a single document and transactions in loans are carried out between one creditor and one debtor. By contrast, debt security issues consist of a large number of identical documents, each evidencing a round sum, which together form the total amount borrowed.
- 5.122 A secondary market in loans exists. In cases where loans become negotiable on an organised market, they are to be reclassified from loans to debt securities, provided that there is evidence of secondary market trading, including the existence of market makers, and frequent quotation of the financial asset, such as provided by bid-offer spreads. An explicit conversion of the original loan is normally involved.
- 5.123 Standardised loans are offered in most cases by financial corporations and they are often granted to households. The financial corporations determine the conditions and the households may only choose either to accept or refuse. The conditions of non-standardised loans, on the other hand, are usually the result of negotiations between the creditor and the debtor. This is an important criterion which facilitates a distinction between non-standardised loans and debt securities. In the case of public security issues, the issue conditions are determined by the borrower, possibly after consulting the bank/lead-manager. In the case of private security issues, however, the creditor and the debtor negotiate the issue conditions.

*Distinction between transactions in loans, trade credit and trade bills*

- 5.124 Trade credit is credit extended directly by the suppliers of goods and services to their customers. Trade credit arises when payment for goods and services is not made at the same time as the change in ownership of a good or the provision of a service.
- 5.125 Trade credit is distinguished from loans to finance trade, which are classified as loans. Trade bills drawn on a customer by the supplier of goods and services, which are subsequently discounted by the supplier with a financial corporation, become a claim by a third party on the customer: provided they are negotiable, such instruments are classified as trade credit and advances.

## Securities lending and repurchase agreements

### Definition

5.126 Securities lending is the temporary transfer of securities by the lender to the borrower. The securities borrower may be required to provide assets as collateral to the securities lender in the form of cash or securities. Legal title passes on both sides of the transaction so that borrowed securities and collateral can be sold or on-lent.

### Definition

5.127 A securities repurchase agreement is an arrangement involving the provision of securities like debt securities or shares in exchange for cash or other means of payment, with a commitment to repurchase the same or similar securities at a fixed price. The commitment to repurchase may be either on a specified future date or an 'open' maturity.

5.128 Securities lending with cash collateral and repurchase agreements (repos) are different terms for arrangements with the same economic effects: those of a secured loan, as both involve the provision of securities as collateral for a loan or a deposit, where a deposit-taking corporation sells the securities under such an arrangement. The different features of the two cases are shown in Table 5.2.

**Table 5.2 Main features of securities lending and repurchase agreements**

Feature	Securities lending		Repurchase agreements	
	Cash collateral	Without cash collateral	Specific securities	General collateral
Formal method of exchange	Lending of securities with an agreement by the borrower to deliver it back to the lender		Sale of securities and commitment to repurchase them under terms of master agreement	
Form of exchange	Securities versus cash	Securities versus other collateral (if any)	Securities versus cash	Cash versus securities
Return is paid to the supplier of	Cash collateral (the securities borrower)	Securities (not collateral securities) (the securities lender)	Cash	Cash
Return repayable as	Fee	Fee	Repo rate	Repo rate



- 5.129 The securities provided under securities lending and repurchase agreements are treated as not having changed economic ownership because the lender is still the beneficiary of the income yield by the security, and subject to the risks or benefits of any change in the price of the security.
- 5.130 The supply and receipt of funds under a securities repurchase agreement, or securities lending with cash collateral, does not involve any new issuance of debt securities. Such provision of funds to institutional units other than monetary financial institutions is treated as loans; for deposit taking corporations it is treated as deposits.
- 5.131 If a securities lending does not involve the supply of cash, that is, if there is an exchange of one security for another, or if one party supplies a security without collateral, there is no transaction in loans, deposits or securities.
- 5.132 Marginal calls in cash under a repo are classified as loans.
- 5.133 Gold swaps are similar to securities repurchase agreements except that the collateral is gold. They involve 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. The transaction is recorded as a collateralised loan or a deposit.

## **Financial leases**

### Definition

- 5.134 A financial lease is a contract under which the lessor as legal owner of an asset conveys the risks and benefits of ownership of the asset to the lessee. Under a financial lease, the lessor is deemed to make, to the lessee, a loan with which the lessee acquires the asset. Thereafter the leased asset is shown on the balance sheet of the lessee and not the lessor; the corresponding loan is shown as an asset of the lessor and a liability of the lessee.
- 5.135 Financial leases may be distinguished from other kinds of leases because the risks and rewards of ownership are transferred from the legal owner of the good to the user of the good. Other kinds of leases are (i) operating lease; (ii) resource lease; and (iii) contracts, leases and licenses.

## **Other types of loans**

- 5.136 The category loans includes the following:
- a) Overdraft on transferable deposit accounts, where the amount overdrawn is not treated as a negative transferable deposit;
  - b) Overdrafts on other current accounts, for example, intra-group balances between non-financial corporations and their subsidiaries, but excluding balances which are liabilities of monetary financial institutions classified in the deposit sub-categories;
  - c) Financial claims of employees because of participation in the corporation's profit;

- d) Repayable margin payments related to financial derivatives which are liabilities of institutional units other than monetary financial institutions;
- e) Loans which are counterparts of bankers' acceptances;
- f) Mortgage loans;
- g) Consumer credit;
- h) Revolving credits;
- i) Instalment loans;
- j) Loans paid as a guarantee for fulfilling certain obligations;
- k) Deposit guarantees as financial claims of reinsurance corporations on ceding corporations;
- l) Financial claims on the IMF evidenced by loans in the General Resources Account, including lending under the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB);
- m) Liabilities to the IMF evidenced by IMF credit or Poverty Reduction and Growth Facility (PRGF) loans; and

5.137 The special case of non-performing loans is discussed in Chapter 7.

#### **Financial assets excluded from loans**

5.138 The category of loans does not include:

- a) Other accounts receivable/payable (AF.8), including trade credit and advances (AF.81); and
- b) Financial assets or liabilities arising from the ownership of immovable assets, such as land and structures, by non-residents. They are classified in other equity (AF.519).

#### *Equity and investment fund shares or units (F.5)*

##### Definition

5.139 Equity and investment fund shares or units are residual claims on the assets of the institutional units that issued the shares or units.

5.140 Equity and investment fund shares is divided into two sub-categories:

- a) Equity (F.51); and
- b) Investment fund shares or units (F.52).

## **Equity (F.51)**

### Definition

- 5.141 Equity is a financial asset that is a claim on the residual value of a corporation, after all other claims have been met.
- 5.142 Ownership of equity in legal entities is usually evidenced by shares, stocks, depository receipts, participations, or similar documents. Shares and stocks have the same meaning.

## **Depository receipts**

### Definition

- 5.143 Depository receipts represent ownership of securities listed in other economies; ownership of the depository receipts is treated as direct ownership of the underlying securities. A depository issues receipts listed on one exchange that represent ownership of securities listed on another exchange. Depository receipts facilitate transactions in securities in economies other than their home listing. The underlying securities may be shares or debt securities.
- 5.144 Equity is sub-categorised into the following:
- a) Listed shares (F.511);
  - b) Unlisted shares (F.512); and
  - c) Other equity (F.519).
- 5.145 Both listed shares and unlisted shares are negotiable, and described as equity securities.

## **Listed shares (F.511)**

### Definition

- 5.146 Listed shares are equity securities listed on an exchange. Such an exchange may be a recognised stock exchange or any other form of secondary market. Listed shares are also referred to as quoted shares. The existence of quoted prices of shares listed on an exchange means that current market prices are usually readily available.

## **Unlisted shares (F.512)**

### Definition

- 5.147 Unlisted shares are equity securities not listed on an exchange.
- 5.148 Equity securities include shares issued by unlisted limited liability companies as follows:

- a) Capital shares which give the holders the status of joint owners and entitle them to a share in the total distributed profits and to a share in the net assets in the event of liquidation.
- b) Redeemed shares whose capital has been repaid but which are retained by the holders who continue to be joint owners and to be entitled to a share in the profits left after dividends have been paid on the remaining registered capital and also to a share in any surplus which may be left on liquidation, i.e. the net assets less the remaining registered capital.
- c) Dividend shares, also called founders' shares, profits shares, and dividend shares, which are not part of the registered capital. Dividend shares do not give the holders the status of joint owners – holders therefore do not have the right to a share in the repayment of the registered capital, the right to a return on this capital, the right to vote at shareholders' meetings, etc. Nevertheless, they entitle the holders to a proportion of any profits remaining after dividends have been paid on the registered capital and to a fraction of any surplus remaining on liquidation.
- d) Participating preference shares or stocks, which entitle holders to participate in the distribution of the residual value of a corporation on dissolution. The holders have also the right to participate in, or receive, additional dividends over and above the fixed percentage dividend. The additional dividends are usually paid in proportion to any ordinary dividends declared. In the event of liquidation, participating preference shareholders have the right to a share of any remaining proceeds that the ordinary shareholders receive, and receive back what they paid for their shares.

### **Initial public offering, listing, delisting, and share buy back**

- 5.149 Initial public offering (IPO), also referred to simply as an 'offering' or a 'flotation,' is when a corporation issues equity securities to the public for the first time. They are often issued by smaller, younger corporations for financing reasons or by large enterprises to become publicly traded. In an IPO the issuer may obtain the assistance of an underwriting entity, which helps to determine what type of equity security to issue, the best offering price and time to bring it to market.
- 5.150 Listing refers to the corporation's shares being on the list of stocks that are officially traded on a stock exchange. Normally the issuing corporation is the one that applies for a listing but in some countries the exchange can list a corporation, for instance because its stock is already being actively traded via informal channels. Initial listing requirements usually include a history of a few years of financial statements; a sufficient size of the amount being placed among the general public, both in absolute terms and as a percentage of the total outstanding stock; and an approved prospectus, usually including opinions from independent assessors. De-listing refers to the practice of removing the shares of a corporation from a stock exchange. This occurs when a corporation goes out of business, declares bankruptcy, no longer satisfies the listing rules of a stock exchange, or has become a quasi-corporation or unincorporated business, often as a result of a merger or acquisition. Listing is recorded as an issuance of listed shares and a redemption of unlisted shares, while

delisting is recorded as a redemption of listed shares and an issuance of unlisted shares if appropriate.

- 5.151 Corporations may buy back their own equity in a share repurchase, also known as a stock repurchase or a share buyback.. A share buyback is recorded as a financial transaction, providing cash to the existing shareholders in exchange for a part of the corporation's outstanding equity. That is, cash is exchanged for a reduction in the number of shares outstanding. The corporation either retires the shares or keeps them as a 'treasury stock', available for re-issuance.

### **Financial assets excluded from equity securities**

5.152 Equity securities do not include:

- a) Shares offered for sale but not taken up on issue. They are not recorded;
- b) Debentures and loan stock convertible into shares. They are classified as debt securities (AF.3) up to the time when they are converted;
- c) The equity of partners with unlimited liability in incorporated partnerships. They are classified as other equity;
- d) Government investments in the capital of international organisations which are legally constituted as corporations with share capital. They are classified as other equity (AF.519);
- e) Issues of bonus shares: the issue without payment of new shares to shareholders in proportion to their holdings. Such an issue, which changes neither the liability of the corporation vis-à-vis the shareholders nor the proportion of the assets that each shareholder holds in the corporation, does not constitute a financial transaction. Share split issues are also not recorded.

### **Other equity (F.519)**

Definition

5.153 Other equity comprises all forms of equity other than those classified in sub-categories listed shares (AF.511) and unlisted shares (AF.512).

5.154 Other equity includes:

- (a) All forms of equity in corporations which are not shares, including the following:
  - (1) The equity in incorporated partnerships subscribed by unlimited partners;
  - (2) The equity in limited liability companies whose owners are partners and not shareholders;
  - (3) The capital invested in ordinary or limited partnerships recognised as independent legal entities;



- (4) The capital invested in cooperative societies recognised as independent legal entities.
- (b) Investments by general government in the capital of public corporations whose capital is not divided into shares, which by virtue of special legislation are recognised as independent legal entities.
- (c) Investment by general government in the capital of the central bank.
- (d) Government investments in the capital of international and supranational organisations, with the exception of the IMF, even if these are legally constituted as corporations with share capital (e.g. the European Investment Bank).
- (e) The financial resources of the ECB contributed by the national central banks.
- (f) Capital invested in financial and non-financial quasi-corporations. The amount of such investments corresponds to new investments in cash or kind, less any capital withdrawals.
- (g) The financial claims that non-resident units have against notional resident units and vice versa.

#### Valuation of transactions in equity

- 5.155 New shares are recorded at issue value, which is nominal value plus the issue premium.
- 5.156 Transactions in shares in circulation are recorded at their transaction value. When the transaction value is not known, it is approximated by the stock exchange quotation or market price for listed shares and by the market-equivalent value for unlisted shares.
- 5.157 Scrip dividend shares are shares valued at the price implied by the issuer's dividend proposal.
- 5.158 Issues of bonus shares are not recorded. However, in cases where the issue of bonus shares involves changes in the total market value of the shares of a corporation, the changes in market value are recorded in the revaluation account .
- 5.159 The transaction value of equity (F.51) is the amount of funds transferred by the owners to corporations or quasi-corporations. In some cases, funds can be transferred by assuming liabilities of the corporation or quasi-corporation.

#### **Investment fund shares or units (F.52)**

##### Definition

- 5.160 Investment fund shares are shares of an investment fund if the fund has a corporate structure. They are known as units if the fund is a trust. Investment funds are collective investment undertakings through which investors pool funds for investment in financial and/or non-financial assets.

- 5.161 Investment funds are also called mutual funds, unit trusts, investment trusts, and undertakings for collective investments in transferable securities (UCITS); they may be open-ended, semi-open or closed-end funds.
- 5.162 Investment fund shares may be listed or unlisted. When they are unlisted, they are usually repayable on request, at a value corresponding to their share in the own funds of the financial corporation. These own funds are revalued regularly on the basis of the market prices of their various components.
- 5.163 Investment fund shares are subdivided into:
- Money market fund (MMF) shares or units (F.521); and
  - Other investment fund shares or units other than MMF shares or units (F.529).

### **Money market fund shares or units (F.521)**

#### Definition

- 5.164 MMF shares or units are shares issued by MMFs. MMF shares or units can be transferable and are often regarded as close substitutes for deposits.

### **Investment fund shares or units other than MMF shares or units (F.529)**

#### Definition

- 5.165 Other investment fund shares or units other than MMF shares or units represent a claim on a portion of the value of an investment fund other than an MMF. Other investment fund shares or units other than MMF shares or units are issued by investment funds.
- 5.166 Other unlisted investment fund shares or units other than MMF shares or units are usually repayable on request, at a value corresponding to their share in the own funds of the financial corporation. These own funds are revalued regularly on the basis of the market prices of their various components.

### **Valuation of transactions in investment fund shares or units**

- 5.167 Transactions in investment fund shares or units include the value of net contributions to a fund.

### **Insurance, pension and standardised guarantee schemes (F.6)**

- 5.168 Insurance, pension and standardised guarantee schemes are divided into six sub-categories:
- a) Non-life insurance technical reserves (F.61);
  - b) Life insurance and annuity entitlements; (F.62)
  - c) Pension entitlements (F.63);
  - d) Claims of pension funds on pension managers (F64);

- e) Entitlements to non-pension benefits (F65); and
- f) Provisions for calls under standardised guarantees (F.66).

### **Non-life insurance technical reserves (F.61)**

#### Definition

- 5.169 Non-life insurance technical reserves are financial claims that non-life insurance policy holders have against non-life insurance corporations in respect of unearned premiums and claims incurred.
- 5.170 Transactions in non-life insurance technical reserves for unearned premiums and claims incurred relate to risks like accidents, sickness, or fire, and also to reinsurance.
- 5.171 Unearned premiums are premiums paid but not yet earned. Premiums are usually paid at the beginning of the period covered by the policy. On an accrual basis, the premiums are earned throughout the policy period, so that the initial payment involves a prepayment or advance.
- 5.172 Claims outstanding are claims due but not yet settled, including cases where the amount is in dispute or the event leading to the claim has occurred but has not yet been reported. Claims due but not yet settled correspond to the reserves against outstanding insurance claims, which are amounts identified by insurance corporations to cover what they expect to pay out arising from events that have occurred but for which the claims are not yet settled.
- 5.173 Other technical reserves, such as equalisation reserves, may be identified by insurers. However, these are only recognised as liabilities and corresponding assets when there is an event giving rise to a liability. Otherwise, equalisation reserves are internal accounting entries by the insurer representing saving to cover irregularly occurring events, and do not represent existing claims of policy holders.

### **Life insurance and annuity entitlements (F.62)**

#### Definition

- 5.174 Life insurance and annuity entitlements consist of financial claims that life insurance policy holders and beneficiaries of annuities have against corporations providing life insurance.
- 5.175 Life insurance and annuity entitlements are used to provide benefits to policy holders upon the expiry of the policy, or to compensate beneficiaries upon the death of policyholders, so are kept separate from shareholders' funds. Reserves in the form of annuities are based on the actuarial calculation of the present value of the obligations to pay future income until the death of the beneficiaries.
- 5.176 Transactions in life insurance and annuity entitlements consist of additions less reductions.
- 5.177 Additions in terms of financial transactions consist of:

- a) Actual premiums earned during the current accounting period; and
- b) Premium supplements, corresponding to the income from the investment of the entitlements attributed to the policy holders after deduction of service charges.

5.178 Reductions consist of:

- a) Amounts due to holders of endowment and similar insurance policies; and
- b) Payments due on policies that are surrendered before maturity.

5.179 In the case of a group insurance taken out by a corporation on behalf of its employees, the employees, but not the employer, are the beneficiaries since they are considered to be the policy holders.

### **Pension entitlements (F.63)**

#### Definition

5.180 Pension entitlements comprises financial claims that current employees and former employees hold against either

- a) Their employers;
- b) A scheme designated by the employer to pay pensions as part of a compensation agreement between the employer and the employee; or
- c) an insurer.

5.181 Transactions in pension entitlements consist of additions less reductions, which are to be distinguished from nominal holding gains or losses on the funds invested by pension funds.

5.182 Additions in terms of financial transactions consist of:

- a) Actual contributions into pension schemes payable by employees, employers, self-employed persons or other institutional units on behalf of individuals or households with claims on the scheme, and earned during the current accounting period; and
- b) Contribution supplements corresponding to the income earned from the investment of the pension entitlements of the pension scheme attributed to participating households, after deduction of service charges during the period for managing the scheme.

5.183 Reductions consist of:

- a) Social benefits equal to the amounts payable to retired persons or their dependants in the form of regular payments or other benefits; and
- b) Social benefits which consist of any lump sums payable to persons when they retire.

## **Contingent pension entitlements**

- 5.184 The category pension entitlements does not include contingent pension entitlements established by institutional units classified as unfunded government defined benefit employer pension schemes or as social security pension funds. Their transactions are not fully recorded and their other flows and stocks are not recorded in the core accounts, but in the supplementary table on pension schemes in social insurance. Contingent pension entitlements are not liabilities of the central government, state government, local government or social security funds sub-sectors and are not financial assets of the prospective beneficiaries.

## **Claims of pension funds on pension managers (F.64)**

- 5.185 An employer may contract with a third party to look after the pension funds for his employees. If the employer continues to determine the terms of the pension schemes and retains the responsibility for any deficit in funding 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 manager 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 manager as well as the administrator.
- 5.186 When the pension manager is a unit different from the administrator and the amount accruing to the pension funds falls below the increase in entitlements a claim of the pension fund on the pension manager is recorded. When the amount accruing to the pension fund exceeds the increase in entitlements, there is an amount payable by the pension fund to the pension manager.

## **Entitlements to non-pension benefits (F.65)**

- 5.187 The excess of net contributions over benefits represents an increase in the liability of the insurance scheme towards the beneficiaries. This item is shown as an adjustment in the use of income account. As an increase in a liability, it is also shown in the financial account. This item is likely to occur only rarely and, for pragmatic reasons, changes in such non-pension entitlements may be included with those for pensions.

## **Provisions for calls under standardised guarantees (F.66)**

### Definition

- 5.188 Provisions for calls under standardised guarantees are financial claims that holders of standardised guarantees have against institutional units providing them.
- 5.189 Provisions relating to calls under standardised guarantees are prepayments of net fees and provisions to meet outstanding calls under standardised guarantees. Like provisions for prepaid insurance premiums and reserves, provisions for calls under standardised guarantees include unearned fees (premiums) and calls (claims) not yet settled.
- 5.190 Standardised guarantees are guarantees that are issued in large numbers, usually for fairly small amounts, along identical lines. There are three parties involved in these

arrangements, the borrower, the lender and the guarantor. Either the borrower or the lender may contract with the guarantor to repay the lender if the borrower defaults. Examples are export credit guarantees and student loan guarantees.

- 5.191 Although it is not possible to establish the likelihood of any particular borrower defaulting, it is usual to estimate how many out of a batch of similar borrowers will default. Much like a non-life insurer, a guarantor working on commercial lines will expect all the fees paid, plus the property income earned on the fees and any reserves, to cover the expected defaults and associated costs and leave a profit. Accordingly a similar treatment to that of non-life insurance is adopted for these guarantees, described as standardised guarantees.
- 5.192 Standardised guarantees cover guarantees on various financial instruments like deposits, debt securities, loans and trade credit. They may usually be provided by a financial corporation, including but not confined to insurance corporations, but also by general government.
- 5.193 When an institutional unit offers standardised guarantees, it charges fees and incurs liabilities to meet the call on the guarantee. The value of the liabilities in the accounts of the guarantor is equal to the present value of the expected calls under existing guarantees, net of any recoveries the guarantor expects to receive from the defaulting borrowers. The liability is called provisions for calls under standardised guarantees.
- 5.194 A guarantee may cover a multi-year period. A fee may be payable annually or up-front. In principle the fee represents charges earned in each year the guarantee holds, with the liability decreasing as the period gets shorter (assuming that the borrower repays in instalments). Thus recording follow that of annuities with the fee paid as the future liability decreases.
- 5.195 The nature of a standardised guarantee scheme is that there are many guarantees of the same type, though not all for exactly the same time period nor all starting and finishing on the same dates.
- 5.196 Net fees are calculated as fees receivable plus fee supplements (equal to the property income attributed to the unit paying the fee for the guarantee) less administration, etc. costs. These net fees may be payable by any sector of the economy and are receivable by the sector in which the guarantor is classified. Calls under standardised guarantee schemes are payable by the guarantor and receivable by the lender of the financial instrument under guarantee, regardless of whether the fee was paid by the lender or the borrower. Financial transactions refer to the difference between the payment of fees for new guarantees and calls made under existing guarantees.

#### **Standardised guarantees and one-off guarantees**

- 5.197 Standardised guarantees are distinguished from one-off guarantees according to two criteria:
- a) Standardised guarantees are characterised by often repeated transactions with similar features and pooling of risks; and
  - b) Guarantors are able to estimate the average loss based on available statistics.

One-off guarantees are individual, and guarantors are not able to make a reliable estimate of the risk of calls. The granting of a one-off guarantee is a contingency and not recorded. Exceptions are certain guarantees provided by government and described in chapter 20.

### **Financial derivatives and employee stock options (F.7)**

5.198 Financial derivatives and employee stock options is divided into two sub-categories:

- a) Financial derivatives(F.71); and
- b) Employee stock options (F.72).

### **Financial derivatives (F.71)**

#### Definition

5.199 Financial derivatives are financial instruments linked to specified financial instrument or indicator or commodity, through which specific financial risks can be traded in financial markets in their own right. Financial derivatives meet the following conditions:

- a) They are linked to a financial or non-financial asset, to a group of assets, or to an index;
- b) They are either negotiable or can be offset on the market; and
- c) No principal amount is advanced to be repaid.

5.200 Financial derivatives are used for a number of purposes including risk management, hedging, arbitrage between markets, speculation and compensation of employees. Financial derivatives enable parties to trade specific financial risks such as interest rate risk, currency, equity and commodity price risk and credit risk, to other entities who are willing to take these risks, usually without trading in a primary asset. Accordingly, financial derivatives are referred to as secondary assets.

5.201 The value of a financial derivative derives from the price of the underlying asset: the reference price. The reference price may relate to a financial or non-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, a basket of prices or other items like emissions trading or weather conditions.

5.202 Financial derivatives can be categorised by instrument such as options, forwards and credit derivatives, or by market risk as currency swaps, interest rate swaps, etc.

### **Options**

#### Definition

5.203 Options are contracts which give the holder of the option the right, but not the obligation, to purchase from or sell to the issuer of the option an asset at a predetermined price within a given time span or on a given date.

The right to purchase is known as a call option, and the right to sell is known as a put option.

- 5.204 The purchaser of the option pays a premium (the option price) for the commitment of the option writer to sell or purchase the specified amount of the underlying asset at the agreed price. The premium is a financial asset of the option holder and a liability of the option writer. The premium can be conceptually considered to include a service charge, which is to be recorded separately. However, in the absence of detailed data, too many assumptions should not be made to identify the service element.
- 5.205 Warrants are a form of options. They give the holder the right but not the obligation to purchase from the issuer of the warrant a certain number of shares or bonds under specified conditions for a specified period of time. There are also currency warrants based on the amount of one currency required to purchase another and cross-currency warrants tied to third currencies as well as index-, basket- and commodity-warrants.
- 5.206 The warrant may be detachable and traded separately from the debt security. As a result, two separate financial instruments are recorded in principle, the warrant as a financial derivative and the bond as a debt security. Warrants with embedded derivatives are classified according to their primary characteristics.

## **Forwards**

### Definition

- 5.207 Forwards are financial contracts under which the two parties agree to exchange a specified quantity of an underlying asset at an agreed price (the strike price) on a specified date.
- 5.208 Futures are forward contracts traded on organised exchanges. Futures and other forward contracts are typically, but not always, settled by the payment of cash or the provision of some other financial asset rather than the delivery of the underlying asset, and therefore are valued and traded separately from the underlying item. Common forward-type contracts include swaps and forward rate agreements (FRAs).

### **Options vis-à-vis forwards**

- 5.209 Options can be contrasted with forwards in that:
- a) At inception, there is usually no up-front payment for a forward contract and the derivative contract begins with zero value; in the case of an option, a premium is paid when the contract is taken out, and at inception the contract is valued at the amount of the premium.
  - b) As market prices, interest rates or exchange rates change during the life of a forward contract, the contract may take on a positive value for one party (as an asset) and a corresponding negative value (as a liability) for the other. These positions may switch between the parties, depending on market developments in the underlying asset in relation to the strike price in the contract. This characteristic makes it impractical to identify transactions in assets separately from transactions in liabilities. Unlike other financial instruments, transactions



in forwards are therefore normally reported net over assets and liabilities. In the case of an option, the buyer is always the creditor and the writer always the debtor.

- c) At maturity, redemption is unconditional for a forward, while for an option it is determined by the buyer of the option. Some options are redeemed automatically when they are positive at maturity.

## **Swaps**

### Definition

- 5.210 Swaps are contractual arrangements between two parties who agree to exchange, over time and according to predetermined rules, streams of payment on an agreed notional amount of principal. The most common types are interest rate swaps, foreign exchange swaps and currency swaps.
- 5.211 Interest rate swaps are an exchange of interest payments of different character on a notional amount of principal, which is never exchanged. Examples of the types of interest rate swapped are fixed rate, floating rate, rates denominated in a currency. Settlements are often made through net cash payments amounting to the current difference between the two interest rates stipulated in the contract applied to the agreed notional principal.
- 5.212 Foreign exchange swaps are transactions in foreign currencies at a rate of exchange stated in the contract.
- 5.213 Currency swaps involve 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.

## **Forward rate agreements (FRAs)**

### Definition

- 5.214 Forward rate agreements are contractual arrangements in which two parties, to protect themselves against interest rate changes, agree on an amount of interest 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 in a similar way as interest rate swaps. The payments are related to the difference between the forward rate agreement rate and the prevailing market rate at the time of settlement.

## **Credit derivatives**

### Definition

- 5.215 Credit derivatives are financial derivatives whose primary purpose is to trade credit risk.

Credit derivatives are designed for trading in loan and security default risk. Credit derivatives may take the form of forward-type or option-type contracts and, like other financial derivatives, are frequently drawn up under standard legal agreements

which facilitate market valuation. Credit risk is transferred from the risk seller, who is buying protection, to the risk buyer, who is selling protection, in exchange for a premium.

- 5.216 The risk buyer pays cash to the risk seller in the event of a default. A credit derivative may also be settled by the delivery of debt securities through the unit that has defaulted.
- 5.217 Types of credit derivatives are credit default options, credit default swaps (CDS) and total return swaps. A CDS index as a traded credit derivative index reflects the development of CDS premiums.

### **Credit default swaps**

#### **Definition**

- 5.218 Credit default swaps (CDS) are credit insurance contracts. They are intended to cover losses to creditors when:
- a) A credit event occurs in relation to a reference unit, rather than being associated to a particular debt security or loan. A credit event affecting the reference entity of concern may be a default, but also a failure to make a payment on any (qualifying) liability that has become due like in case like debt restructuring, breach of covenants, and others.
  - b) A particular debt instrument, typically a debt security or a loan, goes into default. As with swap contracts, the creditor as the buyer of the CDS, the risk buyer makes a series of premium payments to the guarantor, the risk seller.
- 5.219 Where there is no default on the associated unit or the debt instrument, the risk buyer continues paying premiums until the end of the contract. If there is a default, the risk seller compensates the buyer for the loss, and the buyer ceases to pay premiums.

### **Financial instruments not included in financial derivatives**

- 5.220 Financial derivatives does not include:
- a) The underlying instrument upon which the financial derivative is based.
  - b) Structured debt securities that combine a debt security, or a basket of debt securities, with a financial derivative or a basket of financial derivatives, where the derivatives are inseparable from the debt security and the principal initially invested is large compared to the prospective returns from the embedded financial derivatives. Financial instruments where small principal amounts are invested relative to the prospective returns, and which are fully at risk, are classified as financial derivatives. Financial instruments where the debt security component and the financial derivative component are separable from each other are classified accordingly.
  - c) Repayable margin payments related to financial derivatives are classified in other deposits or loans depending on the institutional units involved. However, non-repayable margin payments, reducing or eliminating the asset/liability

positions which may emerge during the life of the contract, are treated as settlements under the contract, and classified as transactions in financial derivatives;

- d) Secondary instruments, which are not negotiable and cannot be offset on the market; and
- e) Gold swaps, which have the same nature as securities repurchase agreements.

### **Employee stock options (F.72)**

#### Definition

5.221 Employee stock options are agreements made on a given date under which an employee has the right to purchase a given number of shares of the employer's stock at a stated price either at a stated time or within a period of time immediately following the vesting date.

The following terminology is used:

The date of the agreement is the 'grant date'

The purchase price agreed is the 'strike price'.

The agreed first date of purchase is the 'vesting date'.

The period after the vesting date in which the purchase can be made is the 'exercise period'

5.222 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. The value of the option is spread over the period between the grant date and vesting date; if the detailed data are lacking they are to be recorded at the vesting date. Thereafter, transactions are recorded at exercise date or, if they are tradable and are actually traded, between the vesting date and the end of the exercise period.

### **Valuation of transactions in financial derivatives and employee stock options**

5.223 Secondary trade in options and closing out options prior to delivery involve financial transactions. If an option proceeds to delivery, it may be exercised or not exercised. In cases where the option is exercised, there may be a payment from the option writer to the option holder equal to the difference between the prevailing market price of the underlying asset and the strike price, or, alternatively, there may be the acquisition or sale of the underlying financial or non-financial asset recorded at the prevailing market price and a counterpart payment between the option holder and the option writer equal to the strike price. The difference between the prevailing market price of the underlying asset and the strike price is in both cases equal to the liquidation value of the option, which is the option price on the terminal date. In cases where the option is not exercised, no transaction takes place. However, the option writer makes a holding gain and the option holder makes a holding loss (in

both cases equal to the premium paid when the contract was taken out) to be recorded in the revaluation account.

- 5.224 The transactions recorded for financial derivatives include any trading in the contracts as well as the net value of settlements made. There may also be the need to record transactions associated with the establishment of derivative contracts. However, in many cases, the two parties will enter into a derivative contract without any payment by one party to the other; in these cases the value of the transaction establishing the contract is nil and nothing is recorded in the financial account.
- 5.225 Any explicit commissions paid or received from brokers or intermediaries for arranging options, futures, swaps, and other derivatives contracts are treated as payments for services in the appropriate accounts. The parties to a swap are not considered to be providing a service to each other, but any payment to a third party for arranging the swap is treated as payment for a service. Under a swap arrangement, where principal amounts are exchanged the corresponding flows are to be recorded as transactions in the underlying instrument; streams of other payments are to be recorded under the item financial derivatives and employee stock options (F.7). While the premium paid to the seller of an option can conceptually be considered to include a service charge, in practice it is usually not possible to distinguish the service element. Therefore, the full price is to be recorded as acquisition of a financial asset by the buyer and as incurrence of a liability by the seller.
- 5.226 Where contracts do not involve an exchange of principal, no transaction is recorded at inception. In both cases, implicitly, a financial derivative with zero initial value is created at that point. Subsequently, the value of a swap will be equal to one of the following:
- a) For principal amounts, the current market value of the difference between the expected future market values of the amounts to be re-exchanged and the amounts specified in the contract; and
  - b) For other payments, the current market value of the future streams specified in the contract.
- 5.227 Changes in the value of the financial derivative over time are recorded in the revaluation account.
- 5.228 Subsequent re-exchanges of principal will be governed by the terms and conditions of the swap contract and may imply financial assets being exchanged at a price different from the prevailing market price of such assets. The counterpart payment between the parties to the swap contract will be that specified within the contract. The difference between the market price and the contract price is then equal to the liquidation value of the asset/liability as it applies on the due date and is recorded as a transaction in financial derivatives and employee stock options (F.7). In total, transactions in financial derivatives and employee stock options must match the total revaluation gain or loss throughout the duration of the swap contract. This treatment is analogous to that set out with respect to options, which proceed to delivery.
- 5.229 For an institutional unit, a swap or a forward rate agreement is recorded under the item financial derivatives and employee stock options on the assets side where it has

a net asset value. Where the swap has a net liability value, it is also recorded on the asset side by convention to avoid flipping between the asset and the liability side. Accordingly, negative net payments increase the net value.

### **Other accounts receivable/payable (F.8)**

#### Definition

- 5.230 Other accounts receivable/payable are financial assets and liabilities created as counterparts to transactions where there is a timing difference between these transactions and the corresponding payments.
- 5.231 Other accounts receivable/payable includes transactions in financial claims which stem from the early or late payment for transactions in goods or services, distributive transactions or financial transactions on the secondary market.
- 5.232 Financial transactions in other accounts receivable/payable comprise:
- a) Trade credit and advances (F.81); and
  - b) Other accounts receivable/payable (F.89).

### **Trade credit and advances (F.81)**

#### Definition

- 5.233 Trade credit and advances are financial claims arising from the direct extension of credit by the suppliers of goods and services to their customers, and advances for work that is in progress or is yet to be undertaken, in the form of prepayment by customers for goods and services not yet provided.
- 5.234 Trade credit and advances arise when payment for goods or services is not made at the same time as the change in ownership of a good or provision of a service. If a payment is made prior to the change of ownership, there is an advance.
- 5.235 FISIM accrued but not yet paid is included with the corresponding financial instrument, usually interest, and prepayment of insurance premiums is included in insurance technical reserves (F.61); in neither case is there an entry in trade credit and advances.
- 5.236 Sub-category trade credit and advances includes:
- a) Financial claims relating to the delivery of goods or services where payment has not taken place;
  - b) Trade credit accepted by factoring corporations except when regarded as a loan;
  - c) Rent of buildings accruing over time; and
  - d) Arrears concerning the payment of goods and services, when not evidenced by a loan.

- 5.237 Trade credit is to be distinguished from trade finance in the form of trade bills, and credit provided by third parties to finance trade.
- 5.238 Trade credit and advances does not include loans to finance trade credit. They are classified in loans.
- 5.239 Trade credit and advances may be divided by original maturity into short-term and long-term trade credit and advances.

### **Other accounts receivable/payable, excluding trade credits and advances (F.89)**

#### Definition

- 5.240 Other accounts receivable/payable are financial claims arising from timing differences between distributive transactions or financial transactions on the secondary market and the corresponding payments.
- 5.241 Other accounts receivable/payable includes financial claims created as a result of the timing difference between accrued transactions and payments made in respect of, for example:
- a) Wages and salaries;
  - b) Taxes and social contributions;
  - c) Dividends;
  - d) Rent; and
  - e) Purchase and sale of securities.
- 5.242 Interest accrued and arrears is recorded with the financial asset or liability on which it accrues, and not as other accounts receivable/payable. If the interest accrued is not recorded as being reinvested in the financial asset, it is classified in other accounts receivable/payable.
- 5.243 For securities lending and gold loan fees, which are treated as interest, the corresponding entries are included under other accounts receivable/payable, rather than with the instrument to which they relate.
- 5.244 Other accounts receivable/payable does not include:
- a) Statistical discrepancies other than timing differences between transactions in goods and services, distributive transactions or financial transactions and the corresponding payments.
  - b) Early or late payment in the creation of financial assets or the redemption of liabilities other than those classified in other accounts receivable/payable. These early or late payments are classified in the relevant instrument category.
  - c) The amounts of taxes and social contributions payable to the general government to be included under other accounts receivable/payable omits that

part of these taxes and social contributions which is unlikely to be collected, and which therefore represents a general government claim of no value.

## CHAPTER 5 ANNEX 1: CLASSIFICATION OF FINANCIAL TRANSACTIONS

5.A1.01 Financial transactions may be classified according to different criteria – by type of financial instrument, negotiability, type of income, maturity, currency and type of interest.

### Classification of financial transactions by category

5.A1.02 Financial transactions are classified in categories and sub-categories as shown in Table 5.3. The classification of the transactions in financial assets and liabilities corresponds to the classification of financial assets and liabilities.

Table 5.3:  
Classification of financial transactions

Category	Code		
Monetary gold and special drawing rights (SDRs)	F.1		
Monetary gold		F.11	
Special drawing rights (SDRs)		F.12	
Currency and deposits	F.2		
Currency		F.21	
Transferable deposits		F.22	
Other deposits		F.29	
Debt securities	F.3		
Short-term		F.31	
Long-term		F.32	
Loans	F.4		
Short-term		F.41	
Long-term		F.42	
Equity and investment fund shares or units	F.5		
Equity		F.51	
Listed shares			F.511
Unlisted shares			F.512
Other equity			F.519
Investment fund shares or units		F.52	



Money market fund shares or units (MMFs)			F.521
Investment fund shares or units other than MMFs			F.522
Insurance , pension and standardised guaranteed schemes	F.6		
Non-life insurance technical reserves		F.61	
Life insurance and annuity entitlements		F.62	
Pension entitlements		F.63	
Claims of pension funds on pension managers		F.64	
Entitlements to non-pension benefits		F.65	
Provisions for calls under standardised guarantees		F.66	
Financial derivatives and employee stock options	F.7		
Financial derivatives other than employee stock options		F.71	
Employee stock options		F.72	
Other accounts receivable/payable	F.8		
Trade credits and advances		F.81	
Other accounts receivable/payable		F.89	

5.A1.03 The classification of financial transactions and of financial assets and liabilities is based primarily on the liquidity, the negotiability and the legal characteristics of the financial instruments. The definitions of the categories are in general independent of the classification of institutional units. The classification of financial assets and liabilities can be further detailed by a cross-classification by institutional unit. An example is the cross-classification of transferable deposits between deposit taking corporations other than the central bank, as inter-bank positions.

### **Classification of financial transactions by negotiability**

5.A1.04 Financial claims can be distinguished by whether they are negotiable or not. A claim is negotiable if its ownership is readily capable of being transferred from one unit to another by delivery or endorsement or of being offset in the case financial derivatives. While any financial instrument can be potentially traded, negotiable instruments are designed to be traded on an organised exchange or ‘over-the-counter’, although actual trading is not a necessary condition for negotiability. Necessary conditions of negotiability are:

- a) Transferability or offsetability in the case of financial derivatives;
- b) Standardisation often evidenced by fungibility and eligibility of an ISIN code; and
- c) That the holder of an asset does not retain the right of recourse against the previous holders.

5.A1.05 . Securities, financial derivatives and employee stock options (AF.7) are negotiable financial claims. Securities include debt securities (AF.3), listed shares (AF.511), unlisted shares (AF.512), and investment fund shares (AF.52). Financial derivatives and employee stock options are not classified as securities even if they are negotiable financial instruments. They are linked to specific financial or non-financial assets or indices through which financial risks can be traded in financial markets in their own right.

5.A1.06 Monetary gold and SDRs (AF.1), currency and deposits (AF.2), loans (AF.4), other equity (AF.519), insurance, pension and standardised guarantee schemes (AF.6) and other accounts receivable/payable (AF.8) are not negotiable..

### Structured securities

5.A1.07 Structured securities typically combine a security, or a basket of securities, with a financial derivative, or a basket of financial derivatives. Financial instruments which are not structured securities are, for instance, structured deposits which combine characteristics of deposits and of financial derivatives. While debt securities typically involve payment at inception of a principal to be repaid, financial derivatives do not.

### Classification of financial transactions by type of income

5.A1.08 Financial transactions are classified by the type of income they generate. The linking of income with the corresponding financial assets and liabilities facilitates calculation of rates of return. Table 5.4 shows the detailed classification by transaction and by income type. While monetary gold and SDRs, deposits, debt securities, loans and other accounts receivable/payable accrue interest, equity pays predominantly dividends, reinvested earnings or withdrawals from income of quasi-corporations. Investment income is attributable to holders of investment fund shares and of insurance technical reserves. The remuneration related to the participation in a financial derivative is not recorded as income, because no principal amount is provided.

**Table 5.4: Classification of financial transactions by type of income**

Financial transactions	Code	Type of income	Code
Monetary gold and special drawing rights (SDRs)	F.1	Interest	D.41
Currency	F.21	None	
Transferable deposits	F.22	Interest	D.41
Other deposits	F.29	Interest	D.41
Debt securities	F.3	Interest	D.41
Loans	F.4	Interest	D.41
Equity	F.51	Distributed income of corporations	D.42
		Reinvested earnings	D.43

Listed and unlisted shares	F.511	Dividends	D.421
		Reinvested earnings	D.43
Other equity	F.519	Withdrawals from income of quasi-corporations	D.422
		Reinvested earnings	D.43
		Dividends	D.421
Investment fund shares or units	F.52	Investment income attributable to investment fund shareholders	D.443
Insurance, pension and standardised guarantee schemes	F.6	Property income attributable to insurance policyholders	D.441
		Property income payable on pension entitlements	D.442
Financial derivatives and employee stock options	F.7	None	
Other accounts receivable/payable	F.8	Interest	D.41

### **Classification of financial transactions by type of interest rate**

5.A1.09 Financial assets and liabilities accruing interest may be broken down by the type of interest rate into fixed, variable, and mixed interest rate.

5.A1.10 For financial instruments with a fixed interest rate the contractual nominal interest payments are fixed in terms of the currency of denomination for the life of the financial instrument or for a certain number of years. At the date of inception, from the debtor's perspective, the timing and value of interest payments and principal repayments are known.

5.A1.11 For financial instruments with a variable interest rate, interest and principal payments are linked to an interest rate, general price index for goods and services or asset price. The reference value fluctuates in response to market conditions.

5.A1.12 Mixed interest rate financial instruments have both a fixed and a variable interest rate over their life and are classified as variable interest rate financial instruments.

### **Classification of financial transactions by maturity**

5.A1.13 For the analysis of interest rates, asset yields, liquidity or debt servicing capacity, a breakdown of financial assets and liabilities by a range of maturities may be required.

### **Short-term and long-term maturity**

Definition

5.A1.14 A financial asset or liability with short-term maturity is repayable on demand at the request of the creditor, or in one year or less. A financial asset or liability with long-term maturity is repayable at some date beyond one year, or has no stated maturity.

### **Original maturity and remaining maturity**

#### Definition

5.A1.15 The original maturity of financial assets or liabilities is defined as the period from the issue date until the final scheduled payment date. A remaining maturity of financial assets or of liabilities is defined as the period from the reference date until the date of the final scheduled payment.

5.A1.16 The original maturity concept is helpful in understanding debt issuance activity. Therefore, debt securities and loans are split by original maturity into short-term and long-term debt securities and loans.

5.A1.17 Remaining maturity is more relevant to analysis of debt positions and debt servicing capabilities.

### **Classification of financial transactions by currency**

5.A1.18 Many of the categories, sub-categories and sub-positions of the financial assets and liabilities may be broken down by the currency in which they are denominated.

5.A1.19 Financial assets or liabilities in foreign currency include financial assets or liabilities denominated in a currency basket, for example SDRs and financial assets or liabilities denominated in gold. A distinction between national currency and foreign currencies is particularly useful for currency and deposits (AF.2), debt securities (AF.3) and loans (AF.4).

5.A1.20 The currency of settlement may be different from the currency of denomination. The currency of settlement refers to the currency into which the value of positions and flows of financial instruments such as securities are converted each time settlement occurs.

### **Measures of money**

5.A1.21 Monetary policy analysis may require measures of money such as M1, M2 and M3 to be identified in the financial account. Measures of money are not defined in ESA 2010.