

**Eighteenth Meeting of the
IMF Committee on Balance of Payments Statistics
Washington, D.C., June 27–July 1, 2005**

Classification of Financial Instruments

BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTTEG)

OUTCOME PAPER (BOPTTEG) # 28

JANUARY 2005

(1) Topic: **Classification of Financial Instruments**

(2) Issues – see BOPTTEG Issues Paper # 28.

(3) Recommendations:

(i) BOPTTEG members agreed with the basic structure of the instruments classification and the principle of harmonization with the *1993 SNA/MFSM*.

(ii) BOPTTEG members agreed with the proposed terminology and the potential usefulness of the additional items specified in the paper.¹ The additional items were:

- mutual funds;
- money market mutual funds;
- quoted/unquoted shares split;
- financial derivatives split by type (forwards/options);
- financial derivatives split by underlying instrument; and
- trade related credit.

(iii) While recognizing the importance of items, several members expressed concern about adding standard items beyond those in the *1993 SNA/MFSM* classifications. The possibility of conveying the idea of items being “standard, if relevant” or some other term that conveys the idea of consideration based on national circumstances was supported, so that potentially important additional items could be identified, taking into account both the importance and cost of each item.

(iv) Several members strongly supported the adoption of mutual funds and money market mutual funds as standard items, based on their growth, importance, particular characteristics, and separate economic function. (As collective investment schemes, they have some aspects in common with pension funds and life insurance.) In addition, money market mutual funds need to be identified separately for compatibility with monetary statistics.

(v) Though the inclusion of a split between financial derivatives and employee stock options was already decided by the AEG, some members noted that cross-border employee stock options would be trivial or zero in many cases, so that some countries would not be burdened by such an item.

¹ The Issues Paper showed a short-term/long-term split for debt securities, being the counterparts of the money market instruments/bonds and notes items in the *BPM5* instrument classification. Some members wished to extend the breakdown by maturity as part of the instrument classification. However, consistent with the other manuals, maturity splits will be considered as an additional dimension rather than as different instrument classes.

(vi) Several members considered that split of financial derivatives into forwards and options was not very useful.

(vii) Some members thought a split of debt securities into quoted and unquoted would be useful, but there was not agreement on this possibility being included as a standard item.

(4) Rejected Alternatives:

None.

(5) Questions for the Committee:

(1) Does the Committee agree with the broad outline of the classification on:

(a) the debt/equity/other grouping in general and the terms used?

(b) the specific items appearing under each of the debt, equity, and other groupings?

(c) any other issues?

(2) Does the Committee agree with the proposals for supplementary items for:

(a) mutual funds? – see 3(iv)

(b) money market mutual funds? – see 3(iv)

(c) forwards/options splits for financial derivatives? – see 3(vi)

(d) the quoted/unquoted split for shares? – see 3(vii)

(e) the underlying instrument split for financial derivatives?

(f) trade-related credit?

(g) any other issues?

Should any of these be made standard items, in particular mutual funds and money market funds as suggested by some BOPTTEG members under (iv) above?

(3) Should the term “supplementary items” be used or should some other term be adopted? – see 3(iii)

IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS
BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTTEG)

ISSUES PAPER (BOPTTEG) # 28

CLASSIFICATION OF FINANCIAL INSTRUMENTS

The views expressed in this paper are those of the authors and do not necessarily represent those of the European Central Bank or IMF.

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BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP

ISSUES PAPER (BOPTTEG) # 28

CLASSIFICATION OF FINANCIAL INSTRUMENTS

Background

In *BPM5*, the instrument classification differs from other manuals, and only appears implicitly in conjunction with the functional and institutional sector classifications. In the new manual, it is proposed to make the classification explicit, review the components, and bring the classification into line with other guidelines.¹

Current international standards for the treatment of the issue

<i>1993 SNA/MFSM</i>	<i>BPM5</i>
Monetary gold and SDRs	The two components are shown separately, not grouped.
Currency and deposits Currency Deposits Transferable deposits Other deposits	The total is not split into the components.
Securities other than shares	Called “debt securities.” Split into: Bonds and notes Money market instruments (“Bonds and notes” and “money market instruments” were defined by maturity, rather than their qualities as instruments.)
Loans	Loans.
Shares and other equity	Called “equities” or “equity securities.” (For direct investment, reinvested earnings is shown separately for transactions only.)
Insurance technical reserves Net equity of households in life insurance reserves Net equity of households in pension funds Prepayment of premiums and reserves against outstanding claims	“Other assets.” (The three components are not shown separately, but are included as supplementary items for national accounts purposes.)
Financial derivatives	Financial derivatives.
Other accounts receivable/payable Trade credit and advances Other	Called “trade credits.” Included with “other assets.”/ “other liabilities”

¹ The Task Force on Financial Markets Statistics of the European System of Central Banks is currently working on the development of a financial instrument classification, which could establish useful links between different sets of statistics (monetary and financial statistics, financial accounts and external statistics) in presentational terms. Some of the elements under consideration by this Task Force are already reflected in the present draft of this paper, in the form of proposals to BOPTTEG members. A draft of this classification will be provided in the December meeting of BOPTTEG as a background document.

(ESA 95 is similar to 1993 SNA and MFSM, but with some additional detail.)

Concerns/Shortcomings of the current treatment

The BPM5 classification differs in some ways from the others. Subsequent developments have given rise to suggestions for additional detail. In addition, clarifications may be needed in some cases.

Possible alternative treatments

General structure:

The *Annotated Outline* (AO) proposes the following classification

Type of Financial Instrument	Corresponding Type of Income
Equity Finance , covering: <ul style="list-style-type: none"> - equity securities <i>of which equity in mutual funds</i> <i>of which equity in money market mutual funds</i> <li style="padding-left: 40px;">-reinvestment of earnings¹ - other equity (not including net equity in insurance technical reserves and pension funds) 	<ul style="list-style-type: none"> } dividends, } withdrawals of income from quasi-corporations (distributed branch profits), } reinvested earnings other: (securities lending)?
Debt , covering: <ul style="list-style-type: none"> - debt securities <ul style="list-style-type: none"> - long-term - short-term - loans - currency and deposits - accounts receivable/payable <ul style="list-style-type: none"> - trade credit and advances - other accounts receivable/payable - other debt instruments <i>of which arrears²</i>	<ul style="list-style-type: none"> } interest } } } } } } } } } other: (securities lending)?
Other instruments , covering: <ul style="list-style-type: none"> - monetary gold - <i>financial gold³</i> - SDRs - net equity in insurance technical reserves and pension funds - financial derivatives and employee stock options <ul style="list-style-type: none"> - financial derivatives <ul style="list-style-type: none"> - forwards - options - employee stock options 	generally none; gold lending fees <i>generally none; gold lending fees</i> rate of return dividends, property income attributed to insurance policy holders none

Possible additional instrument classifications shown in italics.

¹ An imputed instrument for the imputed financial transaction.

² Possible sub-item that could be added as a component of any debt instrument on an “as relevant” basis.

³ Discussed in BOPTTEG Issues Paper # 27.

The proposal follows the *SNA/MFSM* classifications more consistently, while keeping the debt/equity/other grouping (which the *SNA/MFSM* classification does not have).² Of comments on the *AO*, seven agreed with the broad split, while one disagreed, proposing that the other instruments category be omitted.

The presentation above is designed to highlight the instrument/income linkages. “Debt securities” is proposed as a term, rather than “securities other than shares,” for both intelligibility and accuracy (in that financial derivatives could also be considered to be securities). Debt items are supposed to cover both debt securities and deposits/loans.

Possible additional detail of the b.o.p. and i.i.p. standard components and/or in a supplementary presentation

(a) Shares and other equity:

Possible additional detail:

- Shares and other equity excluding mutual fund shares
 - Quoted
 - Unquoted
 - Other equity
- Mutual/Investment fund shares
 - Money market mutual fund shares
 - Other mutual fund shares

The distinction between quoted/unquoted shares also appears in *ESA 95* and the *1993 SNA* (see also DITEG Background Paper #1). The distinction would relate to both valuation methods and analytical concerns. In addition, it would be another way of dealing with requests for separate information on securities traded on financial markets (even if covering only shares) and related concerns that the portfolio investment category is becoming less useful by mixing securities traded on financial markets with those that do not (see also BOPTTEG Issues Paper #12).

Mutual/Investment funds have become increasingly important and they are analytically different from other shares. Furthermore, money market mutual funds are classified as equity but also have liquidity characteristics that suggest they are money. Of the comments on the *AO*, three supported a standard item, eight supported a supplementary item, and one opposed the item because of the data burden.

(b) Financial derivatives in an instrument-related supplementary presentation:

Possibly classified by instrument type:

² However, the classification of insurance technical reserves raises particular difficulties. Existing methodology in *BPM5*, Government Finance Statistics Manual (2001) and the *External Debt Guide* (2003) considers these instruments as debt. The *AO* notes that defined-contribution schemes may not be debt instruments and therefore, this item, which includes both defined-benefit schemes and defined-contribution schemes might be better classified as “other.” This issue will be explored further by the IMF Statistics Department.

- Forwards (including e.g. futures and swaps)
- Options

Possibly classified by underlying financial instrument:

- Fixed income (deposits, loans, debt securities)
- Equities
- Money market and other investment funds shares/units
- Other financial units

The above-mentioned Task Force on Financial Markets Statistics is considering an instrument classification where those four categories would include both the underlying instruments and related financial derivatives. That is, financial derivatives would not be a first level heading in their own right, although they could still be calculated from the components. Of *AO* comments, none thought additional splits should be required, eight thought they should be supplementary items, and two opposed them.

As agreed by the Advisory Expert Group on National Accounts in its February 2004 meeting, the manual will recommend an instrument category “financial derivatives and employee stock options (ESOs)” with the subcategories of (i) financial derivatives and (ii) ESOs. Although ESOs share some characteristics with financial derivatives, they do not meet the definition of financial derivatives. Of *AO* comments, seven agreed, while three disagreed citing that ESOs were derivatives or not significant enough to justify a heading.

(c) Debt instruments (securities and loans/deposits):

A subcategory of debt items could be created in the b.o.p. and i.i.p. standard components and/or in a supplementary presentation for arrears or nonperforming loans, where important.

The possibility of components for arrears was discussed in BOPTEG Issues Paper #3, see Outcome Paper #3.

(d) Trade-related credit:

Trade credit is limited to credit extended by suppliers, so the *Debt Guide* paras. 6.9–11 introduce a wider concept of trade-related credit that includes trade credit, trade-related bills, and credit by third parties to finance trade. Trade-related bills and credit by third parties to finance trade could be identified as a separate component of loans as supplementary information where they are considered statistically significant and analytically useful. Of comments on the *AO*, six agreed, three disagreed. Among the comments were that it should be combined with trade credit or should be a supplementary item.

Questions/Points for discussion

(1) Does the Group agree with the broad outline of the classification on:

(a) the debt/equity/other grouping in general and the terms used?

(b) the specific items appearing under each of the debt, equity, and other groupings?

- (c) any other issues?*
- (2) Does the Group agree with the proposals for shares and other equity on:*
- (a) the quoted/unquoted split for shares as standard or supplementary items?*
 - (b) showing mutual funds separately as standard or supplementary items?*
 - (c) showing money market mutual funds separately?*
 - (d) any other issues?*
- (3) Does the Group agree with the proposals for financial derivatives and ESOs on:*
- (a) the forwards/options splits for financial derivatives as standard or supplementary items?*
 - (b) the underlying instrument split for financial derivatives as standard or supplementary items? with financial derivatives as a main heading or allocated to each underlying risk category?*
 - (c) the treatment of employee stock options?*
 - (d) any other issues?*
- (4) Does the Group agree with the proposals for other items on:*
- (a) trade-related credit being a standard or supplementary item?*
 - (b) any other issues?*

Supplementary information

BPM5 para. 332, standard components

AO Chapter 5 section A

ESA95, Chapter 5 and page 288

MFSM Chapter 4