AMENDMENTS TO THE *FINANCIAL SOUNDNESS INDICATORS (FSIS): COMPILATION GUIDE* (*GUIDE*)[1]

1. Based on the outcome of the Coordinated Compilation Exercise (CCE) for FSIs, the CCE participating countries' views in the area of financial soundness analysis, and the need to enhance comparability of cross-country data, amendments introduced to the *Guide's* recommendations in several areas are described below.

A. Consolidation Basis

2. The *Guide*'s recommendation for a domestically controlled, cross-border consolidation basis (DCCB) for deposit takers (DTs) has been amended. The new recommendation is (i) the cross-border, cross-sector consolidation basis for all domestically incorporated deposit takers (CBCSDI) and/or (ii) the domestically controlled, cross-border, cross-sector (DCCBS) consolidation basis.[2] The recommendation is that FSIs and their underlying data be provided for both these consolidation bases if a country considers that there is significant foreign control of domestically incorporated DTs.[3] Also, a country is encouraged to compile and disseminate FSIs and underlying data series for the branches of foreign DTs (i.e., foreign-controlled institutions that are not domestically incorporated) operating in their territories as supplementary information, if the presence of such branches is deemed by the country as significant.

3. The *Guide's* presentation of alternative consolidation bases (such as domestically controlled, cross-border consolidation basis (DCCB), cross-border consolidation basis for all domestically incorporated deposit takers (CBDI), and domestic consolidation basis (DC)) remains for the reference of countries that may still prefer to use such approaches as best suiting their circumstances.

4. These amendments concern, inter alia, the following sections in the *Guide*: paragraphs 5.31–5.35; Box 5.3; Appendix II: 8.

B. Inter-Group Consolidation Adjustments

5. The *Guide's* recommendation for inter-group consolidation adjustments in the income and expense statement and in the balance sheet has been modified: the *Guide* has ceased to recommend such adjustments. However, with the amendment, the *Guide* leaves open the option to countries if they want to make these adjustments. The *Guide's* presentation of inter-

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[1] These amendments were discussed by the IMF Executive Board on November 7, 2007.

[2] Consistent with prudential frameworks, the recommended consolidation bases for DTs do not include subsidiaries in the insurance subsector or in the nonfinancial corporations sector.

[3] FSIs would be usefully compiled using both consolidation bases when a country deems that the share of foreign-controlled institutions in the sector is not so large so as to render compilation for the domestically controlled part of the sector of little value.

group consolidation adjustments remains to provide a reference for countries that may still prefer to carry out inter-group consolidation adjustments as best suiting their circumstances.

6. These amendments concern, inter alia, the following sections in the *Guide*: paragraphs 5.3–5.5; 5.16; 5.45–5.90; Box 5.1; Box 5.2; Table 5.2; paragraphs 11.35–11.56; 11.57–11.62; 11.63–11.69; Tables 11.2–11.4; Table 11.5; Table 11.6; Table 11.7; Appendix V: 32–57; Tables A5.12–A5.23.

C. Relation of the *Guide* with Basel Committee on Banking Supervision (BCBS) Guidance

7. The *Guide's* statement that it relies on national practice in compiling supervisory-based series has been amended to explicitly defer to BCBS guidance (Basel I and Basel II) as the standards for compiling supervisory-based underlying data series.

8. These amendments concern, inter alia, the following sections in the *Guide*: paragraphs 4.67–4.76; 6.17–6.19; Appendix II: 9–14.

D. Relation of the *Guide* with International Financial Reporting Standards (IFRS)

9. The *Guide*'s departures from IFRS have been addressed so as to defer to IFRS on most accounting issues (see paragraphs 10–16 below), except on matters such as consolidation basis and accounting of loans and provisions (see paragraphs 17–21).

10. ***Principle for recognizing assets and liabilities*:** The *Guide* stated that whether assets and liabilities exist and are outstanding is determined at any moment in time by the principle of ownership. The *Guide's* position is amended to fully defer to IFRS on principles for recognizing assets and liabilities. The International Accounting Standards Board (IASB) framework determines whether assets and liabilities exist and are outstanding on the basis of criteria regarding control and the probability of future economic benefits that can be measured reliably. Moreover, IAS 39 notes that an entity shall recognize a financial asset or liability on its balance sheet when, and only when, the entity becomes a party to the contractual provisions of the instrument, subject to the provisions in respect of regular-way purchases or sales of financial assets. IAS 39 states that a regular-way purchase or sale of financial assets shall be recognized and derecognized, as applicable, using either the trade date or settlement date accounting. The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 3.3–3.6; 4.38.

11. ***Fees and commissions receivable/payable*:** The *Guide* differed from IAS 18 in that it did not adjust the effective yield of a financial instrument for fees that are an integral part of the effective yield of an instrument, but preferred to record them under fees and commissions receivable and payable. The *Guide* is amended to fully defer to IFRS on recording fees and commissions receivable/payable. The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 4.17–4.21; 4.30; Appendix IV: 12–13.

12. ***Gains and losses on available-for-sale assets*:** The *Guide* recommended that gains and losses on available-for-sale assets always be included in the income statement. Under IAS 39, they are recognized in equity except in the case of impairment losses, foreign exchange gains and losses, and when the asset is derecognized. The *Guide* is amended to fully defer to IFRS on recording gains and losses on available-for-sale assets. The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 4.22–4.23; 4.27; Appendix IV: 14–19; Appendix V: 6–20.

13. ***Gains and losses on cash flow hedges, hedges of a net investment in a foreign operation, and (potentially) hedges for the foreign currency risk of a firm commitment*:** The *Guide* recommended that all gains and losses on hedging instruments always be included in the income statement. According to IAS 39, the ineffective portion of gains and losses on the above hedging instruments is recorded in the income statement. Meanwhile, the effective portion of the gains and losses on a cash flow hedge or hedge of a net investment in a foreign operation, and potentially on a hedge for the foreign currency risk of a firm commitment, is accounted directly in equity and is recycled to the income statement only when the hedged transaction affects profit or loss. The *Guide* is amended to fully defer to IFRS on recording gains and losses on cash flow hedges, hedges of a net investment in a foreign operation, and (potentially) hedges for the foreign currency risk of a firm commitment. The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 4.22–4.23; 4.27; 4.56; Appendix IV: 14–19; Appendix V: 6–20.

14. ***Valuation of financial assets:*** The *Guide* used the concepts of tradable and nontradable assets in providing recommendations on valuation. It recommended that broadly market or fair value be used for tradable assets and nominal value be used for nontradable assets. IAS 39 does not recognize the concepts of tradable and nontradable assets in discussing valuation, but makes use of the following concepts instead: (i) financial assets at fair value through profit and loss (designated or held for trading); (ii) available-for-sale financial assets; (iii) loans and receivables; (iv) held-to-maturity investments. The *Guide* is amended to defer to IFRS in the classification of assets for purposes of valuation and the valuation rules that apply to the various categories. According to these rules, broadly, categories (i) and (ii) are valued at market or fair value and categories (iii) and (iv) are valued at amortized cost using the effective interest method (hereafter referred to as amortized cost). The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 3.20–3.33 and Box 4.4. However, the presentation and measurement of loans is nuanced and is discussed below (paragraph 19).

15. ***Valuation of financial liabilities***: The *Guide* recommended that what it termed tradable liabilities be valued at market or fair value and that nontradable ones be valued at nominal value. As in the case of assets (see paragraph 14 above), IAS 39 does not recognize such a classification of liabilities into tradable and nontradable. Broadly, under IAS 39, all financial liabilities are to be valued at amortized cost, except: (a) financial liabilities at fair value through profit or loss, including derivative liabilities, which shall be measured at fair value;

(b) derivative liabilities that are linked to and must be settled by delivery of unquoted equity instruments whose fair value cannot be reliably measured, which shall be measured at cost; (c) financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies, which shall be measured in accordance with IAS 39.29 and IAS 39.31; and (d) financial guarantee contracts and commitments to provide a loan at a below-market interest rate, which shall be measured at the higher of (1) the amount determined in accordance with IAS 37 and (2) the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IAS 18. The *Guide* is amended to defer to IFRS in the classification of liabilities for purposes of valuation and to the valuation rules that apply to the various classes of liabilities. The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 3.20–3.33 and Box 4.4.

16. ***Exchange rate for conversion into the unit of account***: The *Guide* recommended that for conversion of positions the market (spot) exchange rate prevailing on the reference date to which the position relates should be used. However, it also specified that the midpoint between buying and selling rates is preferred. IAS 21.39 says that the closing (spot) exchange rate should be used, but does not note a preference for the midpoint between the buying and selling rate. The *Guide* is amended to follow IFRS, i.e., in not specifying a preference for the midpoint. Regarding the conversion of income and expenses, the *Guide* recommended that the market rate prevailing at the moment when the transaction occurs should be used, while again noting the preference for the midpoint between buying and selling rates. IAS 21.39 says that for the conversion of income and expenses, the exchange rates at the dates of the transactions should be used, without specifying a preference for the midpoint between the buying and selling rates. The *Guide* is amended to follow IFRS, i.e., in not specifying a preference for the midpoint. These amendments concern, inter alia, the following sections of the *Guide*: paragraphs 3.44–3.48.

17. ***Consolidation basis:*** IAS 27 requires that financial statements be prepared for a group that includes the parent company and all of its subsidiaries, irrespective of the sector they belong to. In contrast, the *Guide*'s amended position is that the recommended consolidation bases (CBCSDI or DCCBS)—consistent with prudential frameworks—should not include subsidiaries of DTs in the insurance subsector or in the nonfinancial corporations sector (see also paragraph 2 above).

18. On matters related to the treatment/classification of provisions, no amendments are being made to the *Guide*. The *Guide*'s approach, which is consistent with prudential regulations, has been maintained. The differences from IFRS include the following.

19. ***Presentation and measurement of loans***: The *Guide* recommended that nominal value be used for loans. Under IAS 39, loans and receivables are to be measured at amortized cost.[4] For purposes of compiling FSIs, the following broad concepts of loans are used—(i) gross loans, (ii) nonperforming loans, and (iii) nonperforming loans net of provisions.[5] The recommendation of the *Guide* is clarified on the measurement of the concepts of gross loans and nonperforming loans; these concepts shall be measured at amortized cost, but without any reduction for provisioning for impairment or uncollectibility. Regarding the concept of nonperforming loans net of provisions, it shall be measured at amortized cost, but the reduction for impairment or uncollectibility should be limited to amounts corresponding to specific loan loss provisions (i.e., line 18 (ii) in Table 4.1. in the *Guide*). The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 3.30–3.32.

20. ***Classification of general provisions for financial assets that are neither traded nor recorded at market prices***: The *Guide* recommended that general provisions for losses on financial assets that are neither traded nor recorded at market prices be included in capital and reserves. IAS 39.63 notes that reductions for impairment or uncollectibility (corresponding to both specific and general provisions in other frameworks) should be made from the carrying amount of these assets. The *Guide's* recommendation, i.e., to include provisioning corresponding to general provisions under capital and reserves, is maintained. By the same token, such general provisions should not be reflected (by being deducted) in assets.

21. ***Classification of provisions for potential costs***: The *Guide* recommended that provisions for potential costs be included as general reserves in capital and reserves if such costs can be valued reliably. On the other hand, IAS 37.10 and IAS 37.14 state that provisions for nonfinancial potential costs should be recognized as liabilities when (a) an entity has a present obligation as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. The *Guide's* recommendation, i.e., to include provisions for potential costs in capital and reserves, and not to include them under liabilities, is maintained.

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[4] The concept of loans used in the *Guide*, which is maintained, does not coincide fully with the concept of loans and receivables discussed in IAS 39.

[5] The concept of gross loans (either as total loans, value of large exposures, foreign currency loans, real estate loans, or loans to specific sectors/geographical regions) is used to compile the FSI-underlying series S080, S090, S100, S270, S290, S300, S400, S410, S420, S630, S640, S650, and S660. The concept of nonperforming loans is used to compile the FSI-underlying series S070, and the concept of nonperforming loans net of provisions is used to compile the FSI-underlying series S050. The amended definition of nonperforming loans is discussed below (paragraph 25).

E. Definition of Specific FSIs

22. All FSIs and their underlying series retain the definitions recommended in the *Guide* with the exception of the following definitions.

23. The definition of the data series *"liquid assets,"* underlying the FSIs *"liquid assets to total assets"* and *"liquid assets to short-term liabilities,"* is amended to include interbank positions. The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 4.78–4.81; Appendix II: 54–55; Appendix IV: 108–109.

24. The definition of the data series *"short-term liabilities"* underlying the FSI *"liquid assets to short-term liabilities"* is amended to include interbank positions. The amendment concerns, inter alia, the following sections of the *Guide*: paragraph 4.83; Appendix II: 60.

25. The series "*nonperforming loans*" (NPLs) used to compile the FSIs "*nonperforming loans net of provisions to capital*" and "*nonperforming loans to total gross loans*" are redefined on the basis of a uniform criterion of "principal or interest payments 90 days overdue" for declaring a loan as nonperforming. This implies that the amended definition would not include, as the previous one in the *Guide*, stricter approaches. Moreover, the amended concept of NPLs of the *Guide* would not necessarily correspond to assets that have been assessed as impaired as described in IAS 39. The amendment regarding the definition of NPLs concerns, inter alia, the following sections of the *Guide*: paragraph 4.84–4.87; 6.22–6.24; 6.54–6.55; Appendix II: 15–16; 20–21; Appendix IV: 113–114.

26. The definition of *"net income"* is amended to narrow the definition of net income to net income before taxes and extraordinary items. The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 4.17–4.35; Appendix II: 30; 37.

27. The FSI on *"large exposures"* is redefined as the ratio of the value of large exposures to capital, replacing the versions of the indicator offered as options in the *Guide*. The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 4.76; 4.94–4.95; 6.27–6.30; Appendix II: 74–78; Appendix IV: 118.

28. The FSIs "*net open position in foreign exchange to capital,*" "*large exposures to capital,*" and "*net open position in equities to capital*" are redefined to be compiled using total regulatory capital or Tier 1 capital. The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 6.27–6.30; 6.37; 6.43; Appendix II: 68–70; 79-81; 136–138.

29. The FSI *"number of applications for protection from creditors"* is modified to measure the cases where bankruptcy proceedings are actually initiated. The amendment concerns, inter alia, the following sections of the *Guide*: paragraphs 7.20; Appendix II: 172–174.