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CLASSIFICATION OF FINANCIAL INSTRUMENTS

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1. The views expressed in this paper are those of the authors and should not be attributed to the European Central Bank, International Monetary Fund, its Executive Board, or its management.

Executive Summary

2. Arising from a review of the *BPM5* instruments classification, the paper proposes a number of changes in the *1993 SNA*.

3. One presentational difference is the grouping of instruments into equity, debt, and other components, which already appears in *BPM5*. The use of the *BPM5* term "debt securities" is supported in preference to the *1993 SNA* term "securities other than shares." In addition, the paper proposes a link between each asset type and its corresponding type of income.

4. For equity, the paper raises the possibility of separately identifying each of mutual funds and money market mutual funds as "of which" items under shares and other equity.

5. The possibility of additional components of financial derivatives, by type of instrument or underlying risk is raised. The possibility of showing trade-related credit as a component of loans is also considered.

[1] The original version of this paper was considered at the November-December 2004 meeting of the Balance of Payments Technical Expert Group (BOPTEG), which was set up to consider issues and advise the IMF Committee on Balance of Payments Statistics (the Committee). BOPTEG's recommendations to the Committee are available from the IMF website. The paper will be considered by the Committee at its meeting of June 27-July 1, 2005. The conclusions of the Committee will be supplied to the AEG in time for the July 18-22, 2005 meeting.

Background

6. 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 the *SNA* and other guidelines.[2]

7. Classification issues on traded loans and the distinction between loans and deposits are the subjects of separate papers to be discussed at the July 2005 AEG meeting.

Current international standards for the treatment of the issue

1993 SNA/MFSM	*BPM5*
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"

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

Concerns/shortcomings of the current treatment

[2] 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.

9. The *BPM5* classification differs in some ways from the others. Subsequent developments have given rise to suggestions for additional detail.

Possible alternative treatments

General structure:

10. The Annotated Outline (AO) for the Revision of the Balance of Payments Manual proposes the following classification system:

Type of Financial Instrument	Corresponding Type of Income
Equity finance, covering: - equity securities *of which equity in mutual funds* *of which equity in money market mutual funds* - reinvestment of earnings[1] - other equity (not including net equity in insurance technical reserves and pension funds)	}dividends, }withdrawals of income from quasi- }corporations (distributed branch profits), }reinvested earnings other: (securities lending)?
Debt instruments, covering: - debt securities - loans - currency and deposits - accounts receivable/payable - trade credit and advances - other accounts receivable/payable - other debt instruments	}interest } } } } } } } } other: *securities lending fees?*
Other instruments, covering: - monetary gold - *financial gold*[2] - SDRs - net equity in ins. provisions and pension funds - financial derivatives and employee stock options - financial derivatives - *forwards* - *options* - employee stock options	generally none; *gold lending fees* *generally none; gold lending fees* 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 additional component to be discussed in a later paper.

11. The presentation above does not show the additional breakdowns of instruments by original maturity (*1993 SNA* para.11.58), components of currency and deposits (*1993 SNA* paras.11.70-73), quoted/unquoted split for shares and other equity (*1993 SNA* para.11.86), the split of equity in insurance reserves (1993 SNA, paras. 11.90-99) debt in arrears (*1993*

SNA para.11.101), direct foreign investment (*1993 SNA* para.11.102). In each of these cases, no change to the *SNA* is proposed. The proposal follows the *SNA*/*MFSM* classifications more consistently, while keeping the debt/equity/other grouping (which the *SNA*/*MFSM* classification does not have).[3] The debt items have a common element in the nature of the risk. There is also strong increasing interest in data on debt, because of its particular role in financial soundness and vulnerability.[4] The proposal for the *BPM* could be usefully followed in the *SNA*.

12. The presentation above is designed to highlight the instrument/income linkages, to facilitate estimation of rates and returns and by grouping interest-generating activities together. "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.

13. The presentation loses the hierarchy of the existing classification, mainly in that other accounts receivable/payable is grouped with other kinds of debt. The supposed justification for the existing order as reflecting degree of liquidity may be deemed somewhat weak and, given the huge variation of liquidity within each item, it is considered that the proposed broad grouping under debt is more useful and may provide useful bridges to other widespread concepts like "external debt".

Possible additional detail

(a) Shares and other equity:

14. Possible additional detail:

—Mutual/Investment fund shares

  —Money market mutual fund shares

  —Other mutual fund shares

15. Mutual/Investment funds have become increasingly important and they are analytically different from other shares, in that they play an intermediary role between investors and other types of financial instruments. Furthermore, money market mutual funds are classified as equity but also have liquidity characteristics that suggest they are money.

[3] 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.

[4] See for example, IMF, *External Debt Statistics: Guide for Compilers and Users* and Mark Allen, Christoph Rosenberg, Christian Keller, Brad Setser, and Nouriel Roubini, *A Balance Sheet Approach to Financial Crisis*, IMF Working Paper 02/210

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

16. In view of the growing size and analytical interest in financial derivatives, the following suggestions have been raised as possible additional information:

Possibly classified by instrument type:
—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

17. The above-mentioned ECB 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.

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

18. The possibility of "of which" components for arrears and nonperforming loans are discussed in another AEG paper.

(d) Trade-related credit:

19. 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.

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?
(b) "debt securities" in preference to "securities other than shares"?
(c) other terms used?
(d) the specific items appearing under each of the debt, equity, and other groupings?
(e) the link between income and asset categories?
(f) any other issues?

(2) Does the Group agree with the proposals for shares and other equity on:

(a) showing mutual funds separately as standard or supplementary items?
(b) showing money market mutual funds separately?
(c) any other issues?

(3) Does the Group agree with the proposals for financial derivatives and ESOs on:
(a) the instrument-type split for financial derivatives as standard or supplementary items? or underlying financial risk category?
(b) 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 (pages 43-50)

AO Chapter 5 section A

ESA95, Chapter 5 and page 288

MFSM Chapter 4