
IV. CLASSIFICATION OF FINANCIAL ASSETS

INTRODUCTION

116. This chapter describes the principal characteristics of financial assets and other financial instruments and their classification within the framework of monetary and financial statistics. The recommended classification follows that of the *1993 SNA*.

117. Financial instruments comprise the full range of financial contracts made between institutional units. Financial instruments are classified as *financial assets* or as *other financial instruments*. Financial assets are financial claims (e.g., currency, deposits, and securities) that have demonstrable value. Other financial instruments (e.g., financial guarantees and commitments such as lines of credit, loan commitments, and letters of credit) that are contingent or conditional upon the occurrence of uncertain future events are outside the financial assets boundary and are classified as other financial instruments.

118. Special considerations apply to the compilation of monetary statistics in countries that have Islamic banking systems. Appendix 2 of this manual covers these considerations.

DEFINITION OF FINANCIAL ASSETS

119. This manual and the *1993 SNA* define financial assets as *a subset of economic assets—entities over which ownership rights are enforced, individually or collectively, by institutional units and from which economic benefits can be derived by holding or using the assets over a period of time*. Most financial assets are financial claims arising from contractual relationships entered into when one institutional unit provides funds to another. These contracts are the basis of creditor/debtor relationships through which asset owners acquire unconditional claims on economic resources of other institutional units. The creditor/debtor relationship imparts asset and

liability dimensions to a financial instrument. Despite the absence of a corresponding liability, monetary gold and SDRs are also considered to be financial assets.

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120. The classification scheme of the *1993 SNA* should be used to classify financial assets. This classification scheme is based primarily on two criteria (1) the liquidity of the asset and (2) the legal characteristics that describe the form of the underlying creditor/debtor relationship. The concept of liquidity subsumes other more specific characteristics, such as negotiability, transferability, marketability, or convertibility. These characteristics play a major role in determining the categories, although they are not separately identified. This classification is designed to facilitate the analysis of transactions of institutional units and is a framework for assessing the sources and uses of financing and degree of liquidity for these units.

MONETARY GOLD AND SDRS

121. *Monetary gold and SDRs issued by the IMF are financial assets for which there are no corresponding financial liabilities. Monetary gold consists only of gold held by the central bank or government (or by others subject to the effective control of the central bank or government) as part of official reserves. Gold holdings that are not part of official reserves are classified as nonfinancial assets.*

122. Purchases (sales) of monetary gold are recorded in the accounts of the central bank as increases (decreases) in assets, and the counterparts are recorded as decreases (increases) in assets of the rest of the world. Transactions in nonmonetary gold are treated as transactions in nonfinancial assets.

123. *SDRs are international reserve assets created by the IMF and allocated to members to supplement existing official reserves. IMF members to whom SDRs are allocated do not have an actual (unconditional) liability to repay their SDR allocations. SDRs are held only by IMF member countries and a limited number of international financial institutions that are authorized holders. SDR holdings represent unconditional rights to obtain foreign exchange or other reserve assets from other IMF members.*

CURRENCY AND DEPOSITS

Currency

124. *Currency consists of notes and coins that are of fixed nominal values and are issued by central banks or governments. Currency is divided into separate categories for national currency and foreign currency representing liabilities of central banks or governments in other countries.*

125. Some countries issue gold coins, which are held for intrinsic value, or commemorative coins, which are held for numismatic value. If not in active circulation, such coins should be classified as nonfinancial assets rather than as financial assets.

126. Central bank or central government holdings of unissued or demonetized currency are not financial assets and should not be recorded in sectoral balance sheets.

Deposits

127. *Deposits include all claims on the central bank, other depository corporations, government units, and, in some cases, other institutional units that are represented by evidence of deposit. The category of deposits comprises transferable deposits and other deposits. Separate categories are used for deposits denominated in national currency and for those in foreign currency.*
Transferable Deposits

128. *Transferable deposits comprise all deposits that are (1) exchangeable on demand at par and without penalty or restriction and (2) directly usable for making payments by check, draft, giro*

order, direct debit/credit, or other direct payment facility.

129. Mutual funds sometimes offer accounts with unrestricted check-writing privileges; these are functionally close to transferable deposits. Mutual fund instruments with these characteristics should be classified as transferable deposits.

130. Some types of deposit accounts embody only limited features of transferability. For example, some deposits have restrictions such as on the number of third-party payments that can be made per period and/or on the minimum size of the individual third-party payments. Judgment must be applied in deciding whether deposits with less-than-full transferability features should be classified as transferable deposits in the national context.

Other Deposits

131. *Other deposits comprise all claims, other than transferable deposits, that are represented by evidence of deposit. Typical forms of deposits included under this classification are as follows:*

- Sight deposits that permit immediate cash withdrawals but not direct third-party transfers.
- Savings and fixed-term deposits.
- Nontransferable deposits denominated in foreign currencies.
- Financial corporations' liabilities in the form of shares or similar evidence of deposit that are, legally or in practice, redeemable immediately or at relatively short notice.
- Shares of money-market mutual funds that have restrictions on transferability, such as on the number of checks that may be written per period or on the minimum amount per check.
- Repurchase agreements that are included in the national measures of broad money. Repurchase agreements that are not included

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in broad money should be classified under loans.

132. *Restricted deposits are those for which withdrawals are restricted on the basis of legal, regulatory, or commercial requirements.*⁷

Examples of restricted deposits are as follows:

- Import deposits that are required of importers in advance of importation.
- Transferable deposits that have been posted to depositors' accounts, but that cannot be drawn upon until the deposited items (e.g., checks or drafts) have been collected by the depository corporations that accepted them.
- Compulsory savings deposits arising from an official requirement that a share of a worker's earnings be placed in a deposit account that can be accessed only after a specified period or from which withdrawals may be made only for specified purposes (such as home purchase or retirement).
- Foreign currency deposits that are blocked (i.e., not withdrawal) because of the rationing of foreign exchange as a matter of national policy.
- Deposits in financial corporations that are closed pending liquidation or reorganization.

133. The nature of such restrictions needs to be considered in deciding which, if any, types of restricted deposits should be included in the monetary aggregates, as described in Chapter 6.

⁷Deposit restrictions as defined herein do not include limitations on early withdrawal of deposits that have agreed maturities. A time deposit withdrawal prior to maturity may not be allowed, or, if allowed, typically carries a penalty for early withdrawal. Such withdrawal conditions are treated as standard maturity provisions of time deposits, rather than as deposit restrictions.

SECURITIES OTHER THAN SHARES

134. *Securities other than shares are negotiable instruments serving as evidence that units have obligations to settle by means of providing cash, a financial instrument, or some other item of economic value.* Some common types of securities are government treasury bills, government bonds, corporate bonds and debentures, commercial paper, and certificates of deposit issued by depository corporations. Examples of less common types of securities include tradable depository receipts, notes issued through revolving underwriting facilities (RUFs) and note issuance facilities (NIFs), and securitized mortgage loans and credit card receivables. Loans that have become negotiable de facto should be classified under securities other than shares.

135. *A security provides evidence that a claim exists and specifies the schedule for interest payments and principal repayments.* Common types of securities are those sold on

- a *coupon basis*, stipulating that periodic interest, or coupon, payments will be made during the life of the instrument and that the principal will be repaid at maturity;
- an *amortized basis*, stipulating that interest and principal payments will be made in installments during the life of the instrument;
- a *discount, or zero coupon, basis*, whereby a security is issued at a price that is less than the face (or par) value of the security, and all interest and principal are paid at maturity;
- a *deep discount basis*, whereby a security is issued at a price that is less than face value, and the principal and a substantial part of the interest is paid at maturity; or

- *an indexed basis*, which ties the amount of interest and/or principal payment to a reference index such as a price index or an exchange rate index.

136. Preferred stocks or shares that pay a fixed income but do not provide for participation in the distribution of the residual value of an incorporated enterprise on dissolution are included in this category. Bonds that are convertible into shares should also be classified in this category.

137. Securitization of financial assets is sometimes used in the creation of securities other than shares. Securitization involves the issuance of securities that are backed by financial assets such as mortgage loans, claims on credit cardholders, and other types of loans. The financial assets (e.g., the mortgage loans) that back the securities continue to be shown on the asset side of the balance sheet. The liability side of the balance sheet shows the securities, which are sold to investors who are interested in acquiring indirect claims on the principal and interest payments that are expected to flow from the financial assets that have been securitized.

138. Banker's acceptances are treated as actual financial assets even though no funds may have been exchanged. A banker's acceptance involves the acceptance by a financial corporation of a draft or bill of exchange and the unconditional promise to pay a specific amount at a specified date. The banker's acceptance represents an unconditional claim on the part of the holder and an unconditional liability on the part of the accepting bank; the bank's counterpart asset is a claim on its customer. Banker's acceptances should be classified under the category of securities other than shares.

LOANS

Definition and Classification

139. *Loans are financial assets that (1) are created when a creditor lends funds directly to a debtor, and (2) are evidenced by non-negotiable*

*documents.*⁸ This category includes all loans and advances—except accounts receivable/payable, which are treated as a separate category of financial assets—extended to various sectors by financial corporations, governments, and, in some countries, by other sectors.

140. This category includes installment loans, hire-purchase credit, and loans to finance trade credit. Claims on or liabilities to the IMF that are in the form of loans are also included in this category.

141. Through financial leases, all the risks and rewards of ownership are transferred from the legal owners of goods (lessors) to users of the goods (lessees). Financial leases are classified as loans.

Repurchase Agreements and Lending of Securities and Other Nonloan Assets

142. A securities repurchase agreement (repo) is an arrangement involving the sale, for cash, of securities at a specified price with a commitment to repurchase the same or similar securities at a fixed price either on a specified future date (often one or a few days hence, but increasingly further in the future) or with an “open” maturity⁹. A *repo* is viewed from the perspective of the seller of the securities—i.e., “the cash taker.” The agreement is called a *reverse repo* when viewed from the perspective of the securities buyer—i.e., the “cash

143. Repos convey “full, unfettered ownership” of the securities to the cash provider, which entitles the cash provider to on-sell—i.e., to sell the securities to a third party. Traditionally, on-selling of the securities occurred only if the cash taker defaulted on the repo, but on-selling in non-default situations has become commonplace. Despite the legal conveyance of “full, unfettered

⁸Loans and deposits, which may have almost identical characteristics, are distinguished on the basis of the representation in the documents that evidence them.

⁹“Open” maturity is where both parties agree daily to renew or terminate the agreement. Such an arrangement avoids settlement costs if both parties wish to rollover the repo on a continuing basis.

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ownership” to the cash provider, some ownership rights, in the economic sense, are retained by the cash taker (i.e., the securities provider). In particular, the cash taker retains the market risk and ownership benefits, other than the right of sale, including holding gains or losses and interest income on the securities. Because of these features, a repo is similar to a loan that is collateralized by the securities underlying the agreement.

144. Repos may be used for a variety of different purposes, for example, as a means of financing the acquisition of the underlying instrument; for cash borrowing; or as a means of covering a short position. In some circumstances, substitution of the securities may be permitted¹⁰; also, margin is often provided as added protection against adverse movements in the price of the security. Repurchase agreements are usually “cash driven”, that is, the motivation is to obtain cash (with the security provided as collateral) but they may be “security driven”, where the motivation is to obtain a security when it has “gone special”—i.e., when it has become difficult to obtain. If provided, margin is usually paid by the party initiating the transaction, regardless of whether it is cash or security driven.

145. This manual and the *1993 SNA* recommend that securities repurchase agreements be treated as collateralized loans (or deposits¹¹) rather than as outright sales of securities. Therefore, the securities should remain on the balance sheet of the cash taker, and a new financial asset—i.e., a loan (or deposit)—should be recorded as an asset of the cash provider and a liability of the cash taker.

146. Securities acquired under reverse repo may in turn be repoed. In such a circumstance, the securities under repo support two loan transactions—the cash provider’s claim on the

cash taker under the original repo and the claim of the “on-buyer” (i.e., the cash provider under the new repo) on the original cash provider (i.e., the cash taker under the new repo who is also the cash provider under the first repo/reverse repo). In this situation, the party with the loan asset from the reverse repo does not net it against the loan payable in the subsequent repo because the counterparties to the two transactions are different. No double counting of the holding of the security should arise in such a case, because the securities underlying both the first and the second repos continue to be recorded only on the balance sheet of the original cash taker.

147. This manual makes a specific recommendation on the statistical treatment of securities that are acquired under reverse repo and are on-sold outright. Although a cash provider should not record the acquisition of a security under a reverse repo as a transaction in securities, if the security so acquired is on-sold outright a transaction in the security should be recorded by the cash provider (and by the outright purchaser). This is known as “short selling¹²”—the sale of a financial asset not currently held on-balance sheet—and results in a recorded negative (or “short”) position in the security for the on-seller¹³. This treatment reflects economic reality in that the holder of the negative position is exposed to the risks and benefits of ownership, in an equal and opposite way, as a party in a long position. Interest accrues on the negative position negatively (i.e., the negative position becomes larger). The recording of a negative position overcomes the double counting, in aggregate, that would otherwise result from the security being recorded as an on-balance sheet asset holding of the third party that has purchased it outright, as well as still being recorded on-balance sheet as a security asset holding of the cash taker under the repo.

¹⁰ Similar securities can be substituted if permitted under the agreement “Similar” may be defined very narrowly or more broadly, depending on the circumstances.

¹¹ Repurchase agreements that are included in the national definition of broad money should be classified as non-transferable deposits. All other securities repurchase agreements should be classified under loans.

¹² This treatment should be applied to the recording of all short sales of securities, whether or not associated with repos.

¹³ The relevant security asset category may still record positive holdings if other securities of that category are held on-balance sheet to a greater value than those that have sold “short”.

148. However, in this instance, additional information may be required for a fuller understanding of the repo market and to determine who is holding the instrument. It is often useful for analysis of liquidity, leverage and vulnerability to identify the parties to repo transactions. Accordingly, it is recommended that when a repo (reverse repo) is undertaken, data on the counterparty to the repo (reverse repo) transaction (resident sector or nonresident) and the instrument and sector of issuer (e.g., government debt security) should be provided as supplementary information.

149. *Securities lending* refers to an arrangement whereby a security holder transfers securities to a “borrower,” subject to the stipulation that the same (or similar¹⁴) securities be returned on a specified date or on demand. “Full, unfettered ownership” is transferred to the “borrower,” but the risks and benefits of ownership remain with the original owner.¹⁵ The practice is undertaken by owners of securities to raise the return on the securities and/or to reduce the cost of custody.

150. Securities lending arrangements are divided into two major categories that are delineated by the type of collateral—either cash or securities—that is provided to the lender of the securities¹⁶. The borrower of the securities usually provides collateral that is of equal value to, or greater value than, the value of the securities being lent.

151. Securities lending that is backed by cash collateral is very similar to a repo, and so, is treated statistically in the same way.

152. Securities lending that is backed by non-cash collateral (or that is not collateralized) should be recorded off-balance sheet by both the lender and borrower of the securities, rather than be treated as a transaction. If the securities are on-sold outright

to a third party, the “borrower” of the securities should record a security transaction, and a reduction in security assets, resulting in a negative (“short”) position in that security asset. As with repos, this approach overcomes the double counting that would otherwise result, in the aggregate, from the security being recorded as an on-balance sheet asset holding of the third party that has purchased it outright as well as still being recorded on-balance sheet as a security asset holding of the original lender of the securities.¹⁷

153. Where a security acquired under a securities transaction has been on-sold, additional information may be required to understand securities lending activity and to determine who is holding the instrument. Accordingly, it is recommended that data on the counterparty (resident sector or nonresident) to the securities lending and the instrument and sector of issuer (e.g., government debt security) be provided as supplementary information. In some instances, these data may prove difficult to obtain as it is possible that the owner of the security is unaware that the security is under a security lending arrangement. This situation is common as custodians often obtain blanket agreements from the securities’ owners to lend the securities without obtaining specific approval on each occasion. The custodian usually indemnifies the owner against any loss. When this occurs, the owner may be unaware that a security has been “loaned”. Accordingly, it is recommended that when securities lending without cash collateral is significant, every effort be made to obtain data on this activity from the custodians.

154. *Gold swaps*^{18,19} are forms of repurchase agreements commonly undertaken between central banks or between a central bank and other

¹⁴Similar securities can be substituted if permitted under the lending arrangements. “Similar” may be defined very narrowly or more broadly, depending on the circumstances.

¹⁵If the original owner does not retain these elements of ownership, the provision of the securities should be viewed as an outright sale.

¹⁶In some instances, no collateral is provided.

¹⁷Conceivably, the collateral might be provided in part in securities and the rest in cash. If so, the securities lending should be recorded as a loan in the amount of the cash collateral and, in all other respects, should not be recorded on the balance sheets of the lender and borrower of the securities.

¹⁸These swaps should not be confused with interest rate or currency swaps that are financial derivatives, as described later in this chapter.

¹⁹Gold swaps may be more broadly defined to include arrangements involving nonmonetary gold and parties other than qualified holders of monetary gold.

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types of financial institutions. They occur when gold is exchanged for foreign exchange, at a specified price with a commitment to repurchase the gold at a fixed price on a specified future date so that the original party remains exposed to the gold market. Its features are, therefore, very similar to those of a repo. Consequently, they should be treated in like manner. For example, if one million ounces of gold is swapped by one central bank with another central bank for cash of \$300 million (at the current market price of \$300/oz²⁰), and the price of gold drops to \$250/oz. before the close of the contract, one million ounces will be returned when \$300 million (plus interest) is repaid.

155. Gold swaps should be recorded as collateralized loans when they involve the exchange of gold for cash (in domestic or foreign currency). Consequently, the gold remains on the balance sheet of the original owner and is not taken on to the balance sheet of the cash provider—in the same manner in which a repurchase agreement is recorded. If gold received under a gold swap is swapped again, the same treatment applies—it is treated as a collateralized loan by both parties. In the event that the gold received under a gold swap is sold outright, the seller (if not a monetary authority) should record a negative (“short”) holding of nonmonetary (i.e., commodity) gold and the purchaser (if not a monetary authority) should record on its balance sheet a holding of nonmonetary (i.e., commodity) gold. If the gold acquired under a gold swap is sold outright by a nonmonetary authority to a monetary authority, monetization will be involved²¹. If gold received under a gold swap is sold outright by a monetary authority (whether to a monetary authority or another party), it should record on its balance sheet a negative position in monetary gold. The transaction will involve demonetization if the counterparty in this instance is not a monetary authority.

²⁰ Assuming no payment of margin.

²¹ This could create the situation where monetary gold is overstated, in as far as the same holding of gold would be reported on the balance sheet of two monetary authorities at the same time, if both the originator of the gold swap and the outright purchaser are monetary authorities, and the outright seller is not a monetary authority, as there will be no offsetting negative position—the negative position will be recorded by the nonmonetary authority in nonmonetary gold.

156. *Gold loans* (or gold deposits) may be undertaken to obtain an income return on gold. The gold that is placed on loan (or deposit) may be either a financial asset (i.e., monetary gold) or a nonfinancial asset (i.e., nonmonetary gold.) The gold remains on the books of the gold lender, and the lender retains the exposure to the market risk arising from movements in the market price of gold. Gold loans (or deposits) are not backed by cash collateral and, in some cases, are not backed by non-cash collateral. However, the gold may be on-sold by the borrower. This manual recommends that gold loans be treated as off-balance-sheet items (i.e., not recorded as transactions). If the gold is on-sold, however, the on-selling party (i.e., the gold borrower) should record a gold transaction, in like manner to gold swaps.

157. For all of the above transactions (repos, securities lending, gold swaps and gold loans), if it is not practical to record them as collateralized loans, or in the case of securities lending and gold loans (deposits) as no transaction at all, treating them as transactions in the underlying instrument is an acceptable alternative. For securities lending, as no cash changes hands, if a transaction in the security is recorded, the counter-entry should be an account payable/receivable. For gold loans (deposits) the gold should be demonetized and be recorded as a transaction in nonmonetary gold if either of the counterparties is not a monetary authority. Supplementary information, as a memorandum item, on the value of the underlying asset due to be returned (received) on the reverse leg should also be provided.

158. It should be emphasized that consistency on treatment is important so that if the collateralized approach is not appropriate for any of repos, securities lending, gold swaps or gold loans, they should all be treated as transactions in the underlying assets. If some were treated as transactions in the underlying assets and others as collateralized loans, analytical confusion is likely to result.

159. Recording repos, securities lending, gold swaps and gold loans (reverse transactions) under the collateralized loan approach when the ownership of the underlying asset changes hands,

as set out in this manual, is contrary to the ownership principle in the *1993 SNA*. While there are other types of transactions where a strict change of ownership is not followed (e.g., under a financial lease), the collateralized loan approach for reverse transactions can lead to data that are analytically deficient.

160. For example, if a resident undertakes a reverse repo with a nonresident, which it then follows with an outright sale to another nonresident, two nonresidents would be recorded as holding the same security, thereby overstating external debt. Similarly, if the cash provider in a reverse repo were to go bankrupt before the reverse leg was completed, the cash taker would have no claim on the issuer of the security even though it would still be recording such a claim on its balance sheet. In order to overcome these deficiencies, countries may wish to consider augmenting the presentation of the data. This could be done by recording, in addition to the transaction (position) in a collateralized loan, a transaction in the underlying asset and an obligation (claim) of the counterparty to the transaction to return the asset. In effect, this recognizes two additional transactions and positions outstanding, one extra asset and one extra liability.

161. Consequently, for repos and gold swaps, four financial account transactions would be recorded: a loan (payable/receivable) with a commensurate change in currency and deposits, plus a transaction in the asset, coupled with the recognition of the obligation (right) to return (receive) the asset at the termination of the repo's life as an entry in accounts receivable/payable. For security lending and gold loans, a transaction in the underlying asset would be recorded, coupled with the recognition of the obligation (right) to return (receive) the underlying asset at the termination of the borrowing's (lending's) life as an entry in accounts receivable/payable. For repos and securities lending, interest would accrue on the account receivable/payable at the rate of interest on the underlying security, reflecting the cost of provision of the capital advanced. For gold swaps and gold loans, there is no such interest accrual.

162. Under this "augmented" collateralized loan approach, the underlying asset is recorded as being

held by the party that legally owns it, and has the obligation to return (right to receive back) the underlying asset. In addition, in the case of a repo, a cash loan is also recorded. Inter-sector claims and income attribution are accurately recorded, including for external debt. However, implementing such an approach may represent a major change in the reporting systems in many countries.

163. There are two other possible drawbacks to this approach. First, if a repo is used to finance the acquisition of a security, the continued exposure of the original owner to the particular type of security would only be identified if there were supplementary information (on the instrument and sector of issuer) to indicate which securities have been repoed or lent (borrowed). Second, it could be argued that this approach brings on-balance sheet an off-balance sheet entry (i.e., the commitment to return/right to receive back the underlying security) Also this treatment would result in the "grossing-up" of the balance sheets of the units involved.

164. Despite these limitations, compilers may find this additional information useful where there is concern that the collateralized loan approach is insufficient for analytical needs.

SHARES AND OTHER EQUITY

165. *Shares and other equity comprise all instruments and records acknowledging, after the claims of all creditors have been met, claims on the residual value of a corporation.* Ownership of equity is usually evidenced by shares, stocks, participations, or similar documents. This category includes proprietors' net equity in quasi-corporations, as well as shares and equity in corporations. It also includes preferred stocks or shares that provide for participation in the residual value on dissolution of an incorporated enterprise.²²

²²Preferred stocks or shares that pay a fixed income and do not provide for participation in the distribution of the residual value of an incorporated enterprise on dissolution are included in securities other than shares.

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166. In the context of the monetary statistics in Chapter 7 of this manual, financial corporations' total liabilities in the form of shares and other equity are divided into the following separate components:

- *Funds contributed by owners* include the total amount from the initial and any subsequent issuance of shares, stocks, or other forms of ownership of corporations and quasi-corporations.
- *Retained earnings* constitute all after-tax profits that have not been distributed to shareholders or appropriated as general or special reserves.
- *General and special reserves* are appropriations of retained earnings.²³
- *SDR allocations* are the counterpart to the SDRs that have been provided by the IMF to central banks—the only financial corporations that receive SDR allocations.
- *Valuation adjustment* shows the net counterpart to changes in the value of assets and liabilities on the balance sheets of financial corporations.

167. Disaggregation of shares and other equity into the above categories is a departure from the *1993 SNA*, which treats shares and other equity as a single composite item. The rationale for compiling data on the separate components of shares and other equity on the liability side of the balance sheet, and the accounting rules for valuing these components, are described in Chapter 5 of this manual.

INSURANCE TECHNICAL RESERVES

168. *Insurance technical reserves consist of net equity of households in life insurance reserves and pension funds and prepayments of premiums*

²³In many cases, general reserves are required by law to provide the entity and its creditors with an added measure of protection from the effects of losses. Special reserves also provide added protection, but from the effects of losses that may arise from specific activities of the corporation or quasi-corporation.

against outstanding claims. All these items are considered assets of beneficiaries and policyholders.

Net Equity of Households in Life Insurance Reserves and in Pension Funds

169. This category comprises policyholders' claims on the reserves of insurance corporations and pension funds. These reserves ultimately must be used to provide benefits to policyholders upon their retirement or upon the occurrence of other specified events, or to compensate heirs upon the death of the policyholder. These claims constitute assets of the household sector rather than of insurance corporations or pension funds.

170. *Net equity of households in life insurance reserves* is equal to the discounted present value of a policyholder's expected claims on the future payments of endowments and capital sums (including shared profits) on maturity or in the event of death.

171. Employers or employees establish *pension funds* to provide retirement income or other benefits. They can place the funds either in legally segregated assets administered by employers or beneficiaries or in assets administered by a financial corporation in exchange for a fee. Pension funds are considered assets of the beneficiaries in the household sector rather than assets of the institutional units that manage the funds. Pension funds do not include social security funds, which are considered part of the general government sector.

172. Only the equity of households in funded pension plans is recorded in pension fund accounts, because only these pension plans provide separate pools of asset reserves used to pay benefits. Plans that are unfunded are not segregated from other financial accounts of the pension provider and therefore do not have identifiable assets that can be considered pension fund assets of the household sector.

173. The net equity of households in pension funds relates to claims on the future payment of

income on the attainment of a specified age or at the end of a specified period. The nature of the liability of the pension fund and the asset of the household depends on the nature of the pension plan. In a defined benefit plan, the employer guarantees the level of pension benefits to participating employees. The liability of the defined benefit plan is equal to the present value of the promised benefits. In defined contribution (money purchase) plans, the contributions are fixed, but benefits depend directly on the assets of the fund. The liability of a defined contribution fund, and the assets of households, is equal to the current market value of the assets of the fund.

Prepayments of Insurance Premiums and Reserves Against Outstanding Claims

174. *Prepayments of insurance premiums and reserves against outstanding claims are current claims of policyholders and beneficiaries rather than net equity of insurance corporations.* Prepayments of premiums, which are made by customers at the beginning of the periods covered by their policies, generate reserves for insurance corporations. Such prepayments are considered to be earned by an insurance corporation on a prorated basis during the policy period. These reserves are assets of policyholders.

175. Reserves against outstanding claims are funds set aside by insurance corporations to cover the amounts that they expect to pay out in respect of claims that are not yet settled or claims that may be disputed. Reserves against such outstanding claims are considered to be assets of the beneficiaries and liabilities of the insurance corporations. Policy benefits due to claimants are considered assets of the claimants. Until actually paid, these assets are held by insurance corporations as reserves.

FINANCIAL DERIVATIVES

176. *A financial derivatives contract is a financial instrument that is linked to a specific financial instrument, indicator, or commodity, and through which specific financial risks (such as interest rate risk, currency, equity and commodity price risk, credit risk, etc.) can be traded in their own right in financial markets.* The value of a financial

derivative derives from the price of an underlying item, such as an asset or index. No principal amount is advanced that has to be repaid, and no investment income accrues. Financial derivatives are used for a number of purposes, including risk management, hedging, arbitrage between markets, and speculation.

177. The two broad types of financial derivatives are forward-type contracts and option contracts. In a *forward-type contract*, which is unconditional, two counterparties agree to exchange a specified quantity of an underlying item (real or financial) at an agreed-upon price (the *strike price*) on a specified date. In an *option contract*, the purchaser acquires from the seller a right to buy (or sell, depending on whether the option is a call or a put) a specified underlying item at a strike price on or before a specified date.

178. Characteristics of the major types of financial derivatives are covered in the annex to Chapter 5, which describes the statistical treatment of the stocks and flows associated with such contracts.

OTHER ACCOUNTS RECEIVABLE/PAYABLE

179. *Other accounts receivable/payable include (1) trade credit and advances and (2) other.* Trade credit and advances comprise (1) trade credit extended directly to corporations, government, nonprofit institutions, households, and the rest of the world and (2) advances for work that is in progress (or is to be undertaken) and prepayment for goods and services. Trade credits and advances do not include loans to finance trade credit, which are classified under the category of loans. The *other* category is used to record all items that need to be reviewed for classification elsewhere, as well as accrued taxes and accrued expenses such as rent, wages, and salaries. The *other* category also includes items such as deferred income and provisions for loan losses and other purposes.

OTHER FINANCIAL INSTRUMENTS

180. Many types of contractual financial arrangements between institutional units do not give rise to unconditional requirements either to

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make payments or to provide other objects of value. These arrangements, which are often referred to as contingencies, are not defined as financial assets and should not be recorded in the balance sheets of financial corporations.

Guarantees of payment by third parties are contingencies, because payment is only required if the principal debtor defaults. Lines of credit provide guarantees that funds will be made available, but no financial asset (i.e., loan) is created until funds are actually advanced. Letters of credit are promises to make payment only when certain documents specified by contract are

presented. Note issuance facilities (NIFs) provide guarantees that parties will be able to sell short-term securities (notes) that they issue and that the financial corporations providing the facility will purchase any notes not sold in the market. Only if the financial corporation providing the facility makes funds available will it acquire an actual asset, to be recorded in the balance sheet.

181. Even though excluded from the monetary and financial statistics, data on contingencies should be reported to the compilers of monetary and financial statistics.