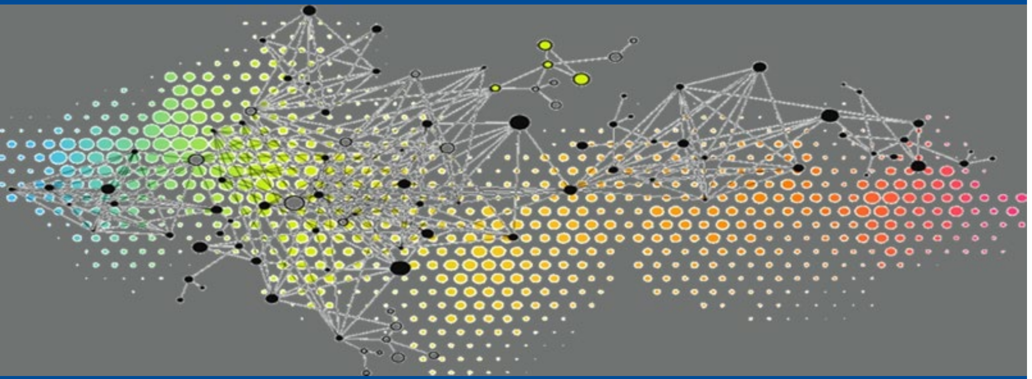

F.4 Derivatives by Type

Sixteenth meeting of the Advisory Expert Group on National Accounts

12-14 July 2021

Outline

- Background
- Issues
- Outcomes
- Outcomes of BOPCOM
- Questions to the AEG

Background

- *BPM6* and *2008 SNA* describe derivatives as financial instruments that are **linked to another** specific financial instrument, indicator, or commodity and through which specific financial risks can be traded in their own right in financial markets;
- A **shortcoming** of the current presentation of derivatives is the lack of information (along several dimensions) on the types of derivatives being recorded, classified in **two broad categories**:
  - Option-type;
  - Forward-type contracts;
    - However, some (e.g., credit default swaps) have a "**dual nature**", with both option- and forward-like characteristics.
- Derivatives can be **further classified** in many other ways:
  - market risk; instrument; trading venue; clearing; delivery type.

Issue 1

Broad Classification of Financial Derivatives

- The broad classification of derivatives as forward-type and option-type instruments does not seem to be widely used in analysis;
- The authors propose to drop the current presentation of derivatives by broad type and replace with a presentation with **more analytically useful** classifications.

Options

- By **market risk category:** foreign exchange; single-currency interest rate; equity; commodity; credit; others;
- By **instrument:** options, forwards and related instruments, futures, swaps, credit derivatives, marketable employee stock options and other instruments;
- By **trading venue** and **clearing status:** exchange traded; OTC (cleared); OTC (not cleared);
- Cross **classification:** market risk category by instrument, trading venue and clearing status;
- By **broad type:** forward-type derivatives; option-type derivatives; hybrid derivatives;
- **No change** to the current presentation of derivatives in *BPM6* and *2008 SNA*.

Issue 2

Compiling Notional Values of Foreign Currency Derivatives

- Only a very limited set of countries actually compile data on the currency composition of the notional amounts of derivatives with foreign currency payment obligations crossed by sectors (*BPM6* Appendix 9, Tables A9 I-Ib and A9-I-2b).

Options

- **Emphasize in the main text** of the updated BPM and SNA that the presentation of foreign currency derivatives notional amounts by currency is requested as described in *BPM6* Appendix 9, Tables A9 I-Ib and A9-I-2b;
- Remove Tables A9-I-Ib, and A9-I-2b, and replace them with a **simplified table** that captures only the essential information on the notional value of foreign currency linked derivatives (as in Annex II);
- **No changes** to this item in the updated BPM and SNA and related documents (compilation guide).

Issue 3

Convention for Recording of Revaluations on Foreign Currency Derivatives

- Any amounts accruing under financial derivatives are classified as revaluations and are included in the other changes for both assets and liabilities;
- Exchange rate movements for this group of derivatives result in price adjustments.

Options

- To enhance analytical clarity on what constitutes an exchange rate revaluation and to comply with *BPM6*, paragraph 9.28, the convention in *BPM6*, paragraph 9.31, shall change so that all **revaluation** effects are due to (other) **price** revaluations **rather than as exchange rate** revaluations for those types of derivatives where it may not be practical to separate exchange rate changes from other revaluation;
- **No change** to the convention currently included in *BPM6*, paragraph 9.31.

Issue 4

Recording of Post Trading Activities

- The changes to the market infrastructures for financial derivatives over the past decade were not included in *BPM6* and *2008 SNA*. Methodological guidance is needed to ensure a symmetric recording across countries, in particular for the issues of novation and portfolio compression which involve CCPs and can have a cross border dimension.

Options

- Expand the current *BPM6* Chapter 8 (Financial Account) and *2008 SNA* Chapter 17 by **providing methodological guidance** for the recording of novation and portfolio compression as financial transactions. Annex III illustrates this in the form of a box designated for the main text of the updated BPM and SNA. **More detailed examples** on novation and portfolio compression shall be presented in the BPM Compilation Guide;
- **No change** to the current presentation of derivatives in *BPM6* and *2008 SNA.*

Issue 5

Gross and Net Recording of Assets and Liabilities

- Both *2008 SNA* and *BPM6* recognize the need for **net recording** of assets and liabilities in some cases, but the guidance for transactions is not fully aligned and is possibly not sufficiently detailed.

Options

- To clarify in paragraph 8.34 of *BPM6* that **recording of transactions on a net basis** is acceptable where separate data on transactions in assets and liabilities are not available, and the position may change between assets and liabilities (e.g., forwards, swaps). The method used should be **consistently applied** during the life of the instrument, not only when switching from assets to liabilities. The same should be included in Chapter 17 of *2008 SNA*;
- **No change** to the current presentation of derivatives in *BPM6* and *2008 SNA*.

Outcomes

Issue 1 – Broad Classification of Financial Derivatives

- Discontinue the current breakdown by broad type in favour of more analytically useful classifications. The following classifications should be introduced: (a) by market risk category (standard component), (b) by instrument, and (c) by trading venue (both b and c are supplementary items). Public consultation respondents overwhelmingly supported the proposal (15 supported each (a) and (b); 10 supported (c); 2 did not support (a) and (b); 7 did not support (c)).
- Review the recommendation in GN F.5 Treatment of Credit Default Swaps in light of the outcome of this GN related to discontinuation of derivatives aggregate breakdown by broad type. Almost all (except one) supported the proposal.

Outcomes

Issue 2 – Broad Classification of Financial Derivatives

- The importance for compiling the currency composition of the notional values of the derivatives linked to foreign currencies (*BPM6* Annex 9) should be emphasized in the updated BPM and SNA. Majority supported this proposal (12). Only three respondents prefer the simplified table from GN Annex II in compiling FX derivatives by currency.

Issue 3 – Convention for Recording of Revaluations on Foreign Currency Derivatives

- Change the convention in *BPM6*, paragraph 9.31, and *2008 SNA* Chapter 17 so that for financial derivatives where it may not be practical to separate exchange rate changes from other revaluations, all revaluations are due to price revaluations rather than exchange rate revaluations. Majority of respondents supported the proposal (14).

Outcomes

Issue 4 – Recording of Post Trading Activities

- Expand the current *BPM6* Chapter 8 (Financial Account) and *2008 SNA* Chapter 11 by providing methodological guidance for the recording of novation and portfolio compression. The respondents supported adding the box on treatment of post trading activities in the updated BPM and SNA, like novation and compression (14).

Issue 5 – Gross and Net Recording of Assets and Liabilities

- Expand the current *BPM6*, paragraph 8.34, and Chapter 17 of *2008 SNA* by providing clarity on the cases in which recording transactions on net basis is acceptable. All respondents supported this recommendation (17), although some stressed that the compilation should be on a gross basis to the extent possible.

Outcomes of BOPCOM

- Most Committee members expressed support for introducing new breakdowns by (i) market risk category (standard component), (ii) instrument (supplementary item), and (iii) trading venue and clearing type (supplementary item) in the *BPM6* update and discontinuing the current breakdown by broad type.

- The Committee also endorsed the proposals to: (i) emphasize in the main text of the updated BPM and SNA that notional values of foreign currency derivatives be compiled by currency; (ii) change the convention in *BPM6* (paragraph 9.31), to attribute all revaluations to other price revaluations rather than exchange rate revaluations for those types of financial derivatives where it may not be practical to separate exchange rate changes from other revaluations; (iii) introduce a Box in *BPM6,* Chapter 8 (Financial Account) and in *2008 SNA,* Chapter 11 to provide methodological guidance for the recording of novation and portfolio compression as financial transactions; (iv) recommend in *BPM6*, paragraph 8.34, and *2008 SNA*, Chapter 17, recording of transactions on a gross basis, while permitting net recording when gross recording is impractical (i.e., for those financial derivatives that can be either an asset or a liability depending on the valuation—e.g., swaps).

Action:

- FITT to await feedback from the AEG and, also subject to its approval, prepare a final version of the GN stating the final recommendations and removing the questions to the Committee for posting on the *BPM6* Update website.

Questions for the AEG

Do the AEG members agree with the proposals to:

- **Issue 1** – Discontinue the current breakdown by broad type and introduce: (a) market risk category (standard component), (b) instrument, and (c) trading venue (both b and c are supplementary items);
- **Issue 2** – Emphasize in the main text of the updated BPM and SNA that the presentation of foreign currency derivatives notional amounts by currency is requested as described in *BPM6* Appendix 9;
- **Issue 3** – Define all revaluation effects are due to price revaluations rather than as exchange rate revaluations for those types of derivatives where it may not be practical to separate exchange rate changes from other revaluation;
- **Issue 4** – Provide methodological guidance for the recording of novation and portfolio compression;
- **Issue 5** – Provide clarity on the cases in which recording transactions on net basis is acceptable.

Annex for Issue 4

Example 1. Recording Positions in Financial Derivatives Before and After Novation

This example shows how two entities (A and B), which are clearing members of a CCP and resident in country X, sign a financial derivative OTC contract, resulting in assets and liabilities of 100 of A and B, respectively. As both entities are resident in country X no positions are recorded in balance of payments and IIP statistics.

Subsequently, the contract is novated to the CCP which is resident in country Y, requiring a recording in balance of payments and IIP statistics. The original contract between A and B is replaced by two new contracts, respectively of A and B with the CCP. As the CCP is resident abroad, the novation creates a cross-border asset position for A and a cross-border liability position for B, while the original purely domestic asset and liability positions of A and B disappear.[15] These changes in asset and liability positions arise entirely from financial transactions as shown in the example.

Globally, the novation results in a doubling of positions compared with the situation before novation. The net IIPs of countries X and Y remain however unchanged at 0.

Table 1. Recording of Positions in Financial Derivatives Before and After Novation

		Entity A	Entity B	CCP
	Resident in country	X	X	Y
1. Before novation				
Vis-à-vis non-residents (IIP)	Assets			
	Liabilities			
Vis-à-vis domestic sectors	Assets	100		
	Liabilities		100	
2. After novation				
Vis-à-vis non-residents (IIP)	Assets	100		100
	Liabilities		100	100
Vis-à-vis domestic sectors	Assets	0		
	Liabilities			0

Example 2. Recording Positions in Financial Derivatives for Portfolio Compression Related Trades

This example shows how three entities (residents A and B, and non-resident C) compress positions outstanding at the end of the previous reporting period.

Table 2. Recording of Positions in Financial Derivatives Arising from Compression

		Entity A	Entity B	Entity C
	Resident in country	X	X	Y
1. Before compression				
Vis-à-vis non-residents (IIP)	Assets	10		20
	Liabilities		20	10
Vis-à-vis domestic sectors	Assets		30	
	Liabilities	30		
Net assets position		-20	10	10
2. After compression				
Vis-à-vis non-residents (IIP)	Assets			10
	Liabilities	10		
Vis-à-vis domestic sectors	Assets		10	
	Liabilities	10		

For the purpose of this example, there are no obstacles for entities to involve in multilateral compression. Entities A and B have both bilateral domestic positions and cross-border positions with non-resident entity C. The net overall position of entity A is a liability (20), while the other two entities each have asset positions (10 + 10). The original deals are "tore up" and replaced with new, lower volume deals that do not change net position of each entity. Note that the new deals are additionally presented as transactions, and the termination of all previous deals should also be recorded as financial transactions. Note that the net international investment position changed for entities A and B in this example (i.e., from assets of 10 to zero for A; and from liabilities of 20 to zero for B) and remained unchanged for entity C (asset 10 before and after compression).

Globally, the compression may change net international investment positions in cross-border deals and reduces the outstanding notional amounts. Net positions of each entity on combined domestic and cross-border segment do not change.