EUROPÄISCHE ZENTRALBANK

2. Dezember 1998

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PRESSEMITTEILUNG

ÜBER DIE VERÖFFENTLICHUNG DES "MONEY AND BANKING STATISTICS COMPILATION GUIDE ADDENDUM 1"

Im April 1998 veröffentlichte das Europäische Währungsinstitut (EWI) den "Money and Banking Statistics Compilation Guide - Guidance provided to the NCBs for the compilation of money and banking statistics for submission to the ECB" ("Compilation Guide") zur Unterstützung der nationalen Zentralbanken (NZBen) bei der Erstellung der statistischen Daten, die sie der Europäischen Zentralbank (EZB) gemäß den statistischen Anforderungen für die dritte Stufe der Währungsunion, die im Bericht "The statistical requirements for Monetary Union" ("Implementation Package") vom Juli 1996 im einzelnen dargelegt sind, einzureichen haben. Der "Compilation Guide" wurde überdies am 1. September 1998 von der EZB formell verabschiedet.

In der Ausgabe des "Compilation Guide" vom April 1998 hieß es, daß diese Richtlinien in regelmäßigen Abständen aktualisiert werden. Eine erste Aktualisierung ist nun aus zweierlei Gründen notwendig geworden. Erstens müssen die aktuellen Richtlinien des "Compilation Guide" in bezug auf den Posten Geldmarktpapiere in der MFI-Bilanzstatistik angepaßt werden, um eine ausreichende Homogenität zu gewährleisten, insbesondere im Sinne einer grenzüberschreitenden Systematik im gesamten Euro-Währungsgebiet und unter Berücksichtigung der Tatsache, daß dieser Posten in die Reservebasis des Mindestreservesystems des Europäischen Systems der Zentralbanken (ESZB) einbezogen ist (siehe Pressemitteilung der EZB vom 8. Juli 1998). Zweitens ergibt sich in einigen Mitgliedsstaaten mit Blick auf die Wechselkredite ein "Klassifizierungsproblem in der zweiten Stufe", während sich der "Compilation Guide" auf die Gegebenheiten in der dritten

Stufe bezieht. In Anbetracht der möglichen Bedeutung für die historischen Reihen erscheint diese Aktualisierung des "Compilation Guide" auch in dieser Hinsicht angezeigt.

Der "Compilation Guide" kann von Interessenten bei ihren jeweiligen nationalen Zentralbanken in der EU angefordert werden. Er ist auch bei der EZB unter folgender Anschrift erhältlich:

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EUROPEAN CENTRAL BANK

MONEY AND BANKING STATISTICS COMPILATION GUIDE

Guidance provided to NCBs for the compilation of money and banking statistics for submission to the ECB

Addendum 1:

Money market paper

Bill-based lending

September 1998

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FOREWORD

In April 1998 the European Monetary Institute (EMI) published the “Money and Banking Statistics Compilation Guide – Guidance provided to the NCBs for the compilation of money and banking statistics for submission to the ECB” (the “Compilation Guide”) to assist national central banks (NCBs) in the compilation of the statistical information that they have to submit to the European Central Bank (ECB) in accordance with the statistical requirements for Stage Three of Monetary Union, as set out in full in the report entitled “Statistical requirements for Stage Three of Monetary Union (Implementation Package)” (July 1996). Moreover, on 1 September 1998, the ECB formally approved the Compilation Guide.

The April 1998 issue stated that the Compilation Guide would be updated periodically. The need for the first such update has now arisen on two accounts. First, the guidance currently contained in the Compilation Guide regarding the money market paper item in the MFI balance sheet statistics needs to be enhanced in order to ensure sufficient homogeneity, especially in terms of cross-border classification across the euro area and taking into account that this item is included in the reserve base of the minimum reserve system of the European System of Central Banks (ESCB) (see press release of the ECB dated 8 July 1998). Second, while the Compilation Guide refers to a Stage Three environment, a “Stage Two classification issue” has arisen in some Member States, with regard to bill-based lending. In view of the possible importance for the historical series, this update of the Compilation Guide is also warranted in this respect.

MONEY MARKET PAPER

GUIDANCE TO ENSURE CONSISTENCY IN CLASSIFICATION WITHIN THE ECB'S MONEY AND BANKING STATISTICS

Introduction

The EMI's "Implementation Package"[1] (IP) requires Monetary Financial Institutions (MFIs) to report statistical data for the purposes of compiling the consolidated balance sheet of the MU-wide MFI sector. Amongst the required liability categories, a clear distinction has to be made between debt securities issued (item 11) and money market paper (item 12). The correct classification of marketable debt instruments to these categories is important, in particular as both might constitute components of the money stock, but the former only up to a certain maturity cut-off point (one or two years).

In order to promote MU-wide consistency in the identification of money market paper (MMP), with the objective of classifying under the money market paper item only debt instruments which have similar liquidity, the definition of MMP was subsequently refined in the context of the "Compilation Guide" (CG).[2, 3]

The CG (fiche 12.1) suggests that "*in order to assist data compilers (MFI reporting agents and NCBs) with the identification of those debt securities that are to be classified as "Money Market Paper", the EMI/ECB will prepare country-by-country guidance to the markets in which money market paper is traded and the types of debt securities that are usually traded in these markets".* The present document aims to fulfil this need.

This document is divided into two parts. The first part develops criteria for the classification of debt instruments under the money market paper category, in terms of the nature of the money market, market liquidity and market participants, which form the key elements in the definition of MMP contained in the IP and developed further within the CG (see attached Annex 1). The document also clarifies further the approach to be taken to overcome difficulties with the identification of MMP. The second part contains national guidelines for the identification of MMP. A summary table of the marketable debt instruments classified as MMP in the IP reporting scheme is attached in Annex 2.

This document will be updated periodically.

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1 "Statistical requirements for Stage Three of Monetary Union (Implementation Package)", July 1996.

2 Where appropriate, the ESCB's draft legal definition of money market funds is consistent with the present conceptual guidance.

3 "Money and Banking Statistics Compilation Guide", April 1998.

Conceptual guidance

The IP contains a definition for item 12, money market paper, of the reporting scheme (cf. Annex 1). In accordance with the IP, the CG defines this statistical category as *marketable instruments issued by MFIs that have a high degree of liquidity because, according to the reporting scheme, "they are traded on liquid markets or (...) the issuer provides full liquidity [for them]".* The CG fiche also provides a definition of "liquid markets", which are considered to be "*those (wholesale) money markets where liquidity is principally exchanged between MFIs and other financial institutions. This encompasses the market for central bank money and markets in which financial institutions exchange liquidity among themselves*". In order to ensure symmetry in the classification of MFI holdings of negotiable debt instruments, the same classification principles should be applied on both sides of the balance sheet.

Should there be any doubt in the classification of debt instruments, the CG suggests that "*it is general practice to record such instruments as MMP if they are intended to be held by other MFIs and have an original maturity of one year or less*".[4] This guideline could, however, encourage MFIs to classify debt instruments, in particular those issued in other Monetary Union Member States (MUMS), as MMP on the basis of their maturity, even if these instruments are not a significant means of exchanging liquidity. With this in mind, the CG recommends that a document offering guidance be prepared to overcome any remaining difficulties with the identification of MMP. The paragraphs below therefore provide further clarification on the concepts of money markets, market liquidity and market participants.

A money market is considered to be a system through which holders of temporary cash surpluses can meet the liquidity needs of agents with temporary cash deficits. According to national practice, a money market can be organised as and/or take the form of a network of market participants and may either be regulated or non-regulated. Price quotations will be made available by the market organisation, brokers, market-makers or by standing offer of the issuer. Information on these prices must be readily available, e.g. on the screens of financial-information providers or via telecommunications facilities. In terms of financial instruments, market participants may receive/place fixed deposits or exchange marketable securities (such as certificates of deposit) or undertake operations involving repos or collateralised loans. Money markets may be restricted to the domestic territory (domestic market) or may extend beyond the national territorial boundaries (international market). Both domestic and international money markets are covered by this definition.[5]

[4] Cf. Compilation Guide, fiche 12.1, paragraph 3.

[5] The domestic money markets of the MUMS will extend to cover the entire single currency area as from the start of Stage Three.

Market liquidity. **A market must have all the following characteristics to be regarded as a liquid money market**:

- **Immediate and low cost convertibility of financial instruments into cash.** This implies that instruments can be repurchased, redeemed or sold at limited cost, in terms of low fees and a narrow bid/offer spread, and with a very short settlement delay.
- **Market depth.** The market is able to absorb a large volume of transactions (turnover) with such trading of large amounts having a limited impact on their market price.[6]
- **Low default risk.** A high credit standard for the issuers, taking into account regulatory criteria which ensure a high level of protection of the holders, is necessary to guarantee certainty in the liquidation value of instruments.
- **Low interest rate risk.** Instruments must generally exhibit a stable price over time in response to changes in interest rates. This is usually the case where residual maturity of instruments is up to, and including, one year, or where regular yield adjustments are in line with money market conditions at least every twelve months.

Market participants mainly include MFIs and other financial institutions, but non-financial corporations may also participate in the market.

Remarks

1. The following marketable debt instruments in particular do not meet the above criteria and should therefore not be classified as MMP:
- fixed-interest bonds with long maturities (e.g. 10-year bank bonds)
- Asset-backed bonds (e.g. mortgage bonds)
- Subordinated bonds.

2. In the light of paragraphs 5.22 and 5.56-5.59 of the ESA 95,[7] MMP would fall under the short-term securities other than shares, excluding financial derivatives item (F.331). As the MU b.o.p. money market instruments (MMI) category could be regarded as very similar to F.331, MMP issued by MFIs can be seen as the most liquid segment of the MMI. MMP may include some instruments with an original maturity of more than one year; however, such instruments would generally include a provision (e.g. floating rates) which make them equivalent to a short-term instrument in terms of interest rate risk. It should be noted that MMI also include short-term instruments issued by all sectors. Those issued by MFIs are recorded regardless of the liquidity of the security, although they are usually tradable on the secondary market.

3. Marketable instruments issued by non-MFIs. The statistical money market paper category only covers marketable instruments issued by MFIs. In some countries, however, institutions other than MFIs may also issue marketable instruments which have the same characteristics as MMP (e.g. Treasury bills and commercial paper). MFI holdings of such instruments should be reported as securities

[6] The depth of the market is usually evidenced by high turnover and sizeable outstanding amounts of the instruments concerned.

[7] "European System of Accounts – ESA 1995", EUROSTAT (June 1996).

other than shares and allocated to the appropriate maturity bands.

BELGIUM

Resident MFIs do not issue MMP in Belgium.

DENMARK

Certificates of deposit (CDs) issued by Danmarks Nationalbank (the Danish national central bank) meet the definition of MMP. CDs are zero coupon paper with a maturity of normally two weeks. They may only be traded between resident Danish banks and Danmarks Nationalbank.

Other Danish MFIs do not issue marketable debt instruments which are traded in national money markets.

GERMANY

In Germany debt securities and other fixed-income securities (other than bills of exchange) issued by MFIs with an original maturity of one year or less (although original maturities under seven days are unusual) meet the MMP definition. The main types of instrument issued by MFIs are certificates of deposit (CDs) and bank bonds (that have an agreed maturity of one year or less; in exceptional cases, e.g. for the short-term absorption of surplus funds in the domestic money market, also Bundesbank liquidity paper). Such instruments tend to have low interest rate and default risks.

MMP is not usually traded on organised markets in Germany; instead, fixed deposits are placed by telephone between two bank counterparties.

In Germany the raising of funds by issuing short-term debt securities plays a minor role in comparison with the issuance of long-term paper. This applies to banks and non-banks alike. One reason for this is that MMP issued by CIs is subject to minimum reserve requirements in Germany.

MMP shall be included in the tier one category of eligible assets if the issuing MFIs fulfil the respective rating criteria (see “The single monetary policy in Stage Three: General documentation on ESCB monetary policy instruments and procedures”, ECB, September 1998).

GREECE

Resident MFIs do not issue MMP in Greece.

SPAIN

In Spain certificates issued by the Banco de España (the Spanish national central bank) are the only instruments issued by resident MFIs to meet the MMP definition.

Banco de España certificates are traded in the interbank market between credit institutions through the money market telephone service.

These certificates were issued by the Banco de España on 23 March 1990 and 3 April 1990 with redemptions in March and September of every year from 1993 to 2000.

Banco de España certificates are included in the assets that fulfil uniform MU-wide eligibility criteria specified by the ECB (tier one) (see “General documentation”, ECB, September 1998).

Other MFIs do not issue marketable debt instruments that meet the MMP definition.

FRANCE

In France four instrument categories are traded on a liquid market for negotiable debt securities other than bonds and Treasury bills ("marché des titres de créances négociables"). However, only certificates of deposit (CDs or "certificats de depôts") and bills issued by financial institutions and financial companies ("bons des institutions et sociétés financières") meet the MMP definition. The two other categories, medium-term notes ("bons à moyen terme négociable") and commercial paper ("billets de trésorerie") are not MMP, either because market turnover is low (i.e. the instruments are illiquid) or because the issuer is not an MFI.

In accordance with Regulation 92-03 of 17 February 1992, the maturity at issue of CDs and of bills issued by financial institutions and financial companies shall not exceed one year.

Following the Regulation 92-03 of 17 February 1992, "CDs may be issued solely by institutions authorised to receive sight deposits and subject to reserve requirements in France and "bills from financial institutions and financial companies" may be issued solely by specialised financial institutions or financial companies whose activity is covered by the amended Article 18-2 of the French Banking Law of 24 January 1984 and which are subject to reserve requirements in France".

CDs and bills issued by financial institutions and financial companies do not fulfil the eligibility criteria applied to tier one or tier two assets.

The MMP category also covers the paper issued by resident credit institutions on the international market that bears the same features as the paper issued on the domestic money market (e.g. as long its initial maturity is lower than one year).

IRELAND

Resident MFIs do not issue MMP in Ireland.

ITALY

Resident MFIs do not issue MMP in Italy.

LUXEMBOURG

Resident MFIs do not issue MMP in Luxembourg.

NETHERLANDS

Resident MFIs do not issue MMP in the Netherlands.

AUSTRIA

Resident MFIs do not issue MMP in Austria.

PORTUGAL

In Portugal instruments issued by the Banco de Portugal (the Portuguese national central bank) meet the MMP definition. These are the central bank intervention bills (TIM) and the central bank monetary certificates (TRM). The maturity at issue is 4, 9, 13, 26 and 52 weeks in the case of TIMs or at 1 to 14 days in the case of TRMs.

These debt instruments are traded in the Market of Intervention Operations (Mercado de Operaçoes de Intervençao - MIT). It is a regulated market in which the Banco de Portugal intervenes, for monetary policy purposes, to exchange liquidity with authorised financial institutions (basically institutions subject to reserve requirements).

Hence, the instruments are held largely by institutions authorised to trade on the MIT and the interbank money market (MMI). However, they can also be traded with mutual funds and pension funds.

The instruments take the form of book-entry securities that are entered into the books in special “securities accounts” opened with the Banco de Portugal.

Other MFIs do not issue marketable debt instruments that meet the MMP definition.

FINLAND

In Finland MMP consists of certificates of deposit (CDs) issued by MFIs and Suomen Pankki (the Finnish national central bank) and traded in the domestic money market. The original maturity of these CDs is mostly up to one year, although it can, in principle, be longer.

CDs are generally used as a means of exchanging liquidity between MFIs and for cash management purposes by other sectors.

CDs are included in the list of eligible instruments (tier two) (see “General documentation”, ECB, September 1998).

SWEDEN

In Sweden paper classified as MMP consists of certificates of deposit (CDs) issued by banks and housing credit institutions. (Both categories are considered as MFIs in Sweden.) The original maturity of these certificates is normally less than one year.

MMP is traded on the over-the-counter (OTC) market. Indicative prices for MMP are, however, given by PMI (Penning Marknads Information), which supplies information on prices for all instruments traded on the money market in Sweden.

The market for MMP is not intense, but nevertheless the issuer of CDs provides full liquidity to maintain the market for these instruments.

CDs are included in the list of eligible assets (tier two) (see “General documentation”, ECB, September 1998).

UNITED KINGDOM

In the United Kingdom the definition of MMP refers to certificates of deposit (CDs) and other paper.

All outstanding CDs issued by MFIs meet the definition of MMP. Certificates of deposit are negotiable instruments in bearer form and may be either interest-bearing, in which case the rate of interest may be fixed or variable, or issued at a discount, in which case they do not carry an interest coupon. By market convention, certificates of deposit are short-term marketable instruments with a maturity of up to five years, although the vast majority are issued with an original maturity of less than one year. Certificates of deposit are traded on a highly liquid secondary market consisting of market-makers (banks, investment houses and brokers) and investors.

It is convenient to group together other marketable instruments traded for liquidity purposes as “other paper”. Other paper consists of all issues of commercial paper and medium-term notes, bonds, FRNs and other instruments issued by MFIs, with the exception of subordinated loan capital of over five years’ maturity.

Existing definition of money market paper

Implementation Package (annex 2).

"*Money market paper.* This consists of mainly short-term securities other than equity issued by reporting MFIs (see "Debt securities issued") traded on liquid markets or for which the issuer provides full liquidity. Certificates of deposit and commercial paper issued by MFIs are likely to fall into this category".

Compilation Guide (fiche 12.1).

12 MONEY MARKET PAPER

12.1 DEFINITION OF MONEY MARKET PAPER

The reporting scheme identifies the liability item "money market paper" as a separate category from "debt securities issued". "Money market paper" is intended to cover marketable instruments issued by MFIs that have a high degree of liquidity because, according to the reporting scheme, "they are traded on liquid markets or (...) the issuer provides full liquidity [for them]".

"Liquid markets" are defined as those (wholesale) money markets where liquidity is principally exchanged between MFIs and other financial institutions. This encompasses both the market for central bank money and markets in which financial institutions exchange liquidity amongst themselves. Turnover in such markets will be sufficiently high to provide the securities traded in these markets with the necessary liquidity to be considered as money market instruments.

Debt securities issued by MFIs that are intended to provide a significant means of exchanging liquidity between MFIs should be placed in the liability category "money market paper", while other debt securities should be placed in the category "debt securities issued". In order to ensure symmetry between the liabilities and assets side of the balance sheet, the same classification principles should be applied to MFI holdings of debt securities. In this regard, should there be any doubt as to whether marketable instruments issued by MFIs should be classified as "money market paper" or as "debt securities issued", it is general practice to record such instruments as "money market paper" if they are intended to be held by other MFIs and have an original maturity of one year or less.

In practical terms, MFI reporting agents will be in a position to identify those debt instruments issued within the domestic territory that are to be classified to the Implementation Package category "money market paper". However, in Stage Three, MFI reporting agents may face difficulties in correctly classifying holdings of debt instruments that are issued in other EU Member States as "money market paper". In order to assist MFI reporting agents in the identification of "money market paper", the EMI/ECB will present in a single document the current national guidelines for the classification of debt instruments to the category "money market paper". This will include information on the national financial markets in which money market paper is traded and the types of debt securities that are usually traded in those markets.

MONEY MARKET PAPER ISSUED BY MFIS

Marketable debt instruments classified as money market paper in the IP reporting scheme

	Market	Type of securities	Maturity	Issuer[8]	Eligibility	Turnover (ECU billion)	IP category 12, money market paper Amount outstanding[9] (ECU billion)
BE	--	--	--	--	--		
DK	Interbank	CDs	Normally 2 weeks	NCB	--		
DE	Domestic money market	CDs/short-term bank bonds	Initial maturity of 1 year or less	MFIs (incl. NCB)	Depending on the ranking of the issuer		CDs 5.39 Short-term bonds 5.89 Liquidity paper 1.98
GR	--	--	--	--	--		
ES	Interbank	Certificates	Until 29/9/2000	NCB	Yes (tier 1)		Certificates 9.178
FR	Negotiable debt securities	CDs	10 days - 1 year	Credit institutions authorised to take sight deposits	No		CDS 102.7
	Negotiable debt securities	Financial company bills	10 days - 1 year	Specialised financial institutions, financial companies	No		Fin. company bills 8.3
IE	--	--	--	--	--		
IT	--	--	--	--	--		
LU	--	--	--	--	--		
NL	--	--	--	--	--		
AT	--	--	--	--	--		
PT	Market of intervention operations	NCB bills	< 1 year	NCB	No		
FI	Domestic money market	CDs	Mostly up to 1 year	NCB/other MFIs	Yes (tier 2)		CDs 23.1
SE	OTC market	CDs	< 1 year	Banks/housing credit institutions	Yes (tier 2)		
UK	London money market	CDs	In general, < 5 years	Banks/building societies	--		CDS Banks 231.1 Building societies 6.3
		CP, bonds, medium-term notes, FRNs, etc.	In general, < 5 years	--	--		Banks 15.4 Building Societies 9.7

-- = not applicable.

[8] Where the issuer is an NCB in a participating Member State of the Monetary Union, no new issues will be made after December 1998.

[9] September 1997.

TREATMENT OF BILL-BASED LENDING OPERATIONS WITHIN THE CONTEXT OF THE LAYERED APPROACH

INTRODUCTION

A need has arisen for clarification of the treatment of bill-based lending operations within the reporting scheme for the aggregated Monetary Financial Institution (MFI) balance sheet statistics that national central banks (NCBs) will be submitting to the European Central Bank (ECB) in accordance with the report entitled “Statistical requirements for Stage Three of Monetary Union (Implementation Package)”. In response to this need, this note outlines the main issues involved and makes a proposal for the classification of these operations within the reporting scheme.

A bill of exchange is commonly defined as a payment order addressed by one person (the drawer) to another requiring the latter (the drawee) to pay a certain amount of money to a specified party or the bearer (the payee or holder) either on demand or at a future date. As a bill is an order to pay a sum, it involves at least two parties, i.e. the drawer and the drawee. If the sum is to be paid to a third party, there is also a payee. When a bill is payable at a future date, it must be accepted by the drawee. By accepting the bill, the drawee is liable to redeem the bill at maturity (i.e. to pay the holder of the bill its face value). MFIs normally become involved in bill operations in two ways. When the bill is accepted by a bank, it is called a *bank acceptance* or *bank bill*. Bills other than bank acceptances are termed *trade bills*.

This note is divided into three sections. The *first section* includes a fiche setting out the proposed treatment of bill-based lending operations. The intention is to incorporate this fiche into the “Money and Banking Statistics Compilation Guide – Guidance provided to the NCBs for the compilation of money and banking statistics for submission to the ECB” (the “Compilation Guide”) during the next update. The *second section* develops a set of recommendations on the treatment of trade bills and, with regard to implementation, considers whether deviations from these recommendations would give rise to significant distortions within the consolidated balance sheet of the MU-wide MFI sector. The *third section* adapts these recommendations to the case of bank acceptances. Two annexes are also attached, which provide practical examples concerning the accounting treatment of bill-based lending operations.

SECTION 1 - FICHE ON BILL-BASED LENDING

A bill of exchange is a payment order whereby one party (the drawer) directs another (the drawee) to pay a certain amount of money at a future date. MFIs may be involved either as holders of bills drawn on non-MFIs (in the case of trade bills) or as the drawee (in the case of bank acceptances).

The Layered Approach scheme does not foresee any specific treatment for bill-based lending within MFI balance sheet statistics. The classification of trade bills and bank acceptances held by or claimed on MFIs has two aspects: the sector classification of the lending counterparties and the instrument category into which these instruments should be classified. The classification of bank acceptances can be seen as a variant of that of trade bills.

As far as the first aspect is concerned, it is recommended that MFIs classify holdings of trade bills drawn on non-MFIs as claims on the final debtor (the drawee principle). This reflects the fact that when a bill is sold all the associated risks and rewards are transferred and the holder has a primary claim on the drawee, but only a contingent claim on the previous holders. This approach is consistent with the European System of Accounts 1995 (ESA 95).[10] The alternative option, which is to classify trade bills as claims on the previous holder (the presenter principle), should be avoided.

In accordance with the recommendations provided within the Compilation Guide[11] and with the ESA 95,[12] trade bills should be recorded either under the item “loans” or under the item “securities other than shares” or “money market paper” as appropriate, depending on the degree of standardisation of these documents and on the structure of the secondary markets in which they are traded.

The treatment of bank acceptances is twofold:

[10] Applying the presenter principle alone would lead to difficulties if (unconsolidated) financial accounts data were to be provided separately for sub-sectors such as the NCBs (ESA S. 121), the ECB or other MFIs (S. 122).

[11] Fiches 3.1, 11.1 of the Compilation Guide (April 1998) and “Money market paper – guidance to ensure consistency in classification across the MUMS” contained in this Addendum.

[12] According to paragraph 5.58 of the ESA 95 (and paragraphs 11.74 and 11.75 of the SNA 93), financial transactions based on bills of exchange or bank acceptances should generally be classified under the short-term securities other than shares excluding financial derivatives sub-category (F. 331). Classification according to paragraph 5.59 of the ESA 95 should only be applied if the negotiability of bills of exchange or bank acceptances is very restricted.

1. The accepting bank should classify the original acceptance as a loan to the drawer (i.e. the party on whose behalf the acceptance was granted) and, if it goes into circulation, the resultant liability should be recorded under the item “debt securities issued”; however, an alternative accounting treatment may be adopted, provided that this does not cause significant distortions.
2. From the viewpoint of an MFI which is the holder of the bank acceptance, these instruments are classified in the same way as trade bills, i.e. according to the drawee principle (and thus as a liability of the bank accepting the paper, not of the original issuer).

SECTION 2 - TRADE BILLS

Definition: A vendor of goods (the drawer) presents a bill to the purchaser of goods (the drawee) which the purchaser accepts (thus becoming the acceptor). The vendor may then raise cash by selling the bill to (have the bill discounted by) a third party (the holder), usually an MFI. On maturity, the holder presents the bill to the acceptor for due payment.

Obligations: (a) The current holder has a claim on the acceptor; (b) where there is a recourse clause, the current holder has a contingent claim on the previous holders of the bill (which materialises only if the acceptor fails to redeem the bill on maturity).

MFI balance sheet recognition

The creation of a trade bill does not initially entail the involvement of the MFI sector. A trade bill essentially evidences a trade credit provided by the vendor of goods to the purchaser, the bill being dated to mature when the payment is due from the purchaser, at which point the purchaser (as acceptor) pays the holder the face value of the bill and is thereby discharged from the trade credit.

The MFI sector becomes involved when the vendor presents the trade bill to an MFI for discounting. In discounting (purchasing) the bill, the MFI provides the vendor with cash funds equal to the discounted face value of the bill (the face value being the value of the transaction in goods). The economic rationale is that the MFI is releasing early to the vendor the funds locked in the trade debt. The MFI may retain the trade bill or on-sell it to other MFIs, including the central bank.

In this case, the subsequent holders of the bill will have a claim on two parties: a direct claim on the acceptor (as the party from whom the holder will receive due payment on maturity) and a contingent claim on previous holders of the bill (assuming there is recourse to previous holders should the acceptor fail to make payment).

There are two possible approaches to the treatment of holdings of bills in the MFI balance sheet. In the first approach, the current holder classifies the bill as a claim on

the drawee (the drawee principle) and the (recourse) claim on the previous holder is treated as a contingency. The second approach involves the current holder having a claim on the party that sold the bill (the presenter principle).

These approaches reflect differences in the status accorded to the obligations arising under trade bills and in their economic rationale. According to the presenter principle, it is the contingent claim of each holder towards previous holders and the liability to the subsequent holder that are being brought onto the balance sheet as current assets and liabilities. This possibly reflects the strict legal position according to which bills are not fully negotiable and hence the inability to transfer full title to a third party means that each supposed sale of bills does not extinguish the obligations/rights of the seller, but instead creates new obligations of the seller towards the buyer. In economic terms, the sale of bills does not represent a financial transaction, but rather a refinancing operation on the part of the seller. The drawee principle instead views the sale of bills as a transaction in bills and the residual obligations that remain are treated as contingent liabilities.

In order to decide which treatment is most appropriate for statistical purposes, it is necessary to examine the principles of balance sheet recognition adopted in MU monetary statistics. These principles, which are consistent with the ESA 95, are set out in the Compilation Guide. The Guide states (in respect of trust loans)[13] that a change in ownership should be measured where substantially all the "risks and rewards" of ownership have been transferred. In respect of the sale of bills, this is clearly the case, as the new holder has a primary claim on the drawee and only a contingent claim on the previous holders. Hence the drawee principle is closer to satisfying the statistical requirements than the presenter principle.

Instrument classification

Another question is how to classify trade bills within the correct Implementation Package item ("loans", "securities other than shares" or "money market paper"). The instrument classification will depend to a large extent on the way in which bills will be recognised in the balance sheet.

The bill might be discounted by an MFI which holds it in portfolio until maturity, or it could be sold to another party (i.e. put into circulation). The Compilation Guide fiches 3.1 and 11.1 on traded loans provide recommendations on the treatment of trade bills in both sets of circumstances. When traded on organised secondary markets and restructured into a large number of identical documents, traded loans (which represent a general category which includes bills of exchange) should be classified under the item "securities other than shares" or the item "money market paper", as appropriate.[14] If trade bills are not traded on organised secondary markets, e.g. on account

[13] Cf. fiche 2.4.

[14] Cf. the ESA 95, paragraphs 5.78 and 5.79.

of their lack of fungibility, they should be classified under the item "loans".

Implementation

The proposed recommendation for the implementation of this issue within the framework of the Layered Approach is that trade bills should be recorded according to the drawee principle, which is the accounting principle adopted in most countries.

The two approaches mentioned may produce some differences in the consolidated balance sheet of the MFI sector when the bills circulate outside the MFI sector. In this case, the initial sale of bills to a non-MFI creates a claim on the MFI whichever accounting approach is adopted (see Annex 1). Also, subsequent on-selling to other non-MFIs does not cause problems in respect of monetary statistics. The only difficulty will occur where the same bills are regularly traded between MFIs and non-MFIs. Where the drawee principle is applied, the deposit created when the non-MFI purchases a bill is cancelled when the bill is sold, whereas where the presenter principle is applied, the original deposit remains, with the sale being represented by a liability to the purchaser. Where that purchaser is an MFI, non-MFI deposit liabilities to MFIs and MFI lending to non-MFIs are both inflated. Should the holder MFI subsequently sell the same bills to the non-MFI sector, the distortion then increases.

While monetary statistics will focus on the global position of the MFI sector as a whole, it should be noted that the MFI balance sheet may be needed as an input for financial accounts, where data must be provided separately for the ECB, the NCBs and the other MFIs. Therefore, the application of the presenter principle would cause difficulties in the production of such statistics.

SECTION 3 – BANK ACCEPTANCES

Definition: An entity requiring short-term finance draws a bill on a bank which the bank accepts. In order to discharge a liability, the entity may pass the bill to a non-MFI (e.g. a vendor of goods). Another possibility is that the accepting bank discounts (purchases) the bill and holds it in portfolio or later sells the bill, usually to another bank. On maturity, the bank (as acceptor) repays the holder of the bill with the amount received from the entity that drew the bill.

Obligations: (a) The accepting bank has a claim on the party that drew the bill (the drawer); (b) if there is a recourse clause, the current holder of the bill has a contingent claim on the previous holders (which crystallises only if the accepting bank fails to redeem the bill on maturity); (c) the current holder has a claim on the accepting bank.

MFI balance sheet recognition

The recognition of bank acceptances gives rise to two issues: first, the treatment of the initial acceptance by the accepting bank and, second, the treatment of subsequent transactions, should the accepted bill go into circulation.

In terms of the initial acceptance, the accepting bank provides cash, if it has discounted its own acceptance, in exchange for a commitment by the drawer to (re)pay the accepting bank the face value of the bill on or just before maturity. The economic substance of this relationship is that the accepting bank is providing a cash loan to the drawer for the life of the bill.[15]

This relationship is independent of the obligations that arise under the terms of the bill itself if it is subsequently put into circulation. In this case, bank acceptances should be treated in the same way as trade bills. As shown in the example of Annex 2, the only difference is that an MFI is the drawee, i.e. the final debtor, and an entry must be made in the liabilities side of its balance sheet, representing the liability to the holder of the bill.

Therefore, as with trade bills, this practice might give rise to an increase in the deposits of the non-MFI sector and in the loans to the non-MFI sector.

Instrument classification

Where the accepting MFI purchases its own acceptances, these bills are effectively withdrawn from circulation; when the bill falls due the MFI is left to present the bill to itself for payment. In this case, it seems appropriate to classify acceptances as advances (loans) rather than as securities, because the MFI simply retains a claim on the customer on whose behalf the MFI accepted the bill and from whom, on the due date, it will expect to receive funds to meet the face value of the bill. The ESA 95 provides explicit guidance[16] recommending that in such cases “the financial corporation’s counterpart transaction is a transaction in a short-term loan made by the financial corporation to its customer”.

When acceptances circulate, they should be treated in the same way as trade bills.

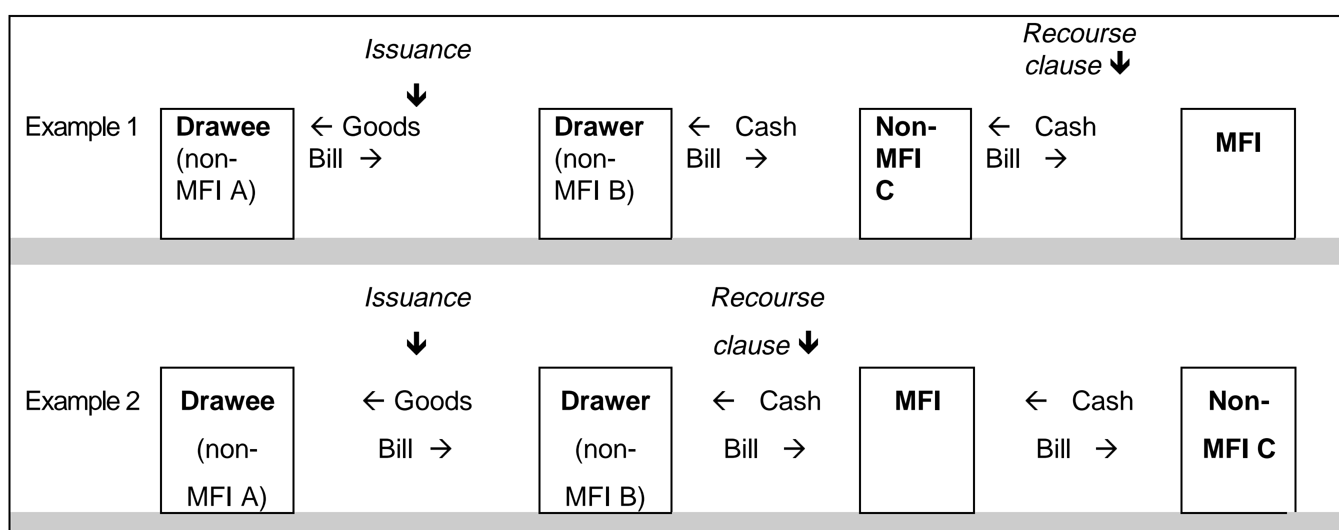
[15] The classic example of bill finance is where a bill is drawn to enable the seller of goods to obtain cash as soon as they are despatched and to enable the buyer to defer payment until at later date. If such a bill is drawn on a bank instead of the true buyer, it becomes a bank bill. Increasingly common (in particular in the United Kingdom), however, are *finance bills*, which are created not to finance a particular commodity transaction, but as a source of general short-term finance. Finance bills are drawn by opening revolving credits with banks: that is, when a bill matures the company can draw another to replace that being withdrawn. The bill is discounted in the market so that the drawer obtains the necessary funds. In some cases, the accepting banks themselves discount the bills and hold them to maturity. Here, the transaction is virtually the same as giving loan facilities to the borrower, but the banks can sell the bills in the market.

[16] Cf. paragraphs 5.58d and 5.81f.

However, another position should be recorded on the liabilities side by the accepting MFI. It refers to the holder of the bank acceptance in circulation which, according to ESA 95, should be included within the item "short-term securities other than shares, excluding financial derivatives". However, having regard to different national accounting practices, the ESA 95 also requires a degree of flexibility in the application of this recommendation to take into account national practices and variations in the nature of these instruments. Again, the above-mentioned Compilation Guide fiches on traded loans provide a general recommendation for this purpose.

Trade Bills

MFIs record positions in trade bills according to the presence of a recourse clause and the approach (presenter/drawee) chosen. Two examples are shown here.[17] In Example 1, trade bills are sold first to a non-MFI and then to an MFI, whereas in Example 2 they are sold first to an MFI, then to a non-MFI. The following chart illustrates the circulation of the trade bill.



The outcome is shown in the following table. The MFI will record the following positions:

	Presenter principle		Drawee principle	
	With recourse	Without recourse	With recourse	Without recourse
Example 1	Loans to non-MFI (C)	Loans to non-MFI (A)	Loans to non-MFI (A)	Loans to non-MFI (A)

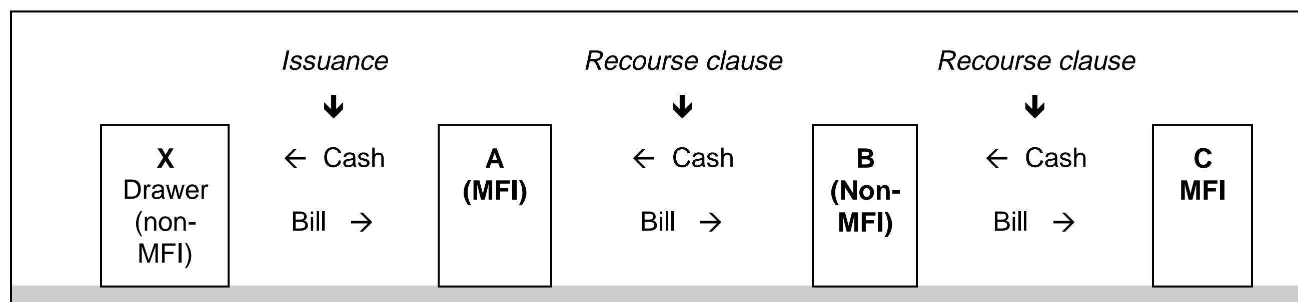
[17] The most common reason for MFIs to purchase bills is to refinance themselves at NCBs, i.e. to obtain central bank money. For the purpose of this note, however, the examples illustrate only cases of bills circulating outside the MFI sector.

Example 2	Loans to non-MFI (B) and deposit from non-MFI (C)	Loans to non-MFI (A) and deposit from non-MFI (C)	Off-balance sheet	No recording

In the first example, no differences between the two approaches occur (except for the possible different sub-sector classification of the non-MFI). A difference does, however, appear in the second example. When an MFI sells trade bills to non-MFIs, the application of the presenter principle would lead to the recording of non-MFI claims on the MFI sector (which might potentially contribute to the monetary aggregates), whereas according to the drawee principle this business would be considered as lending within the non-MFI sector.

Bank acceptances

A bill drawn by a non-MFI is accepted and discounted by one MFI (A), then sold to a non-MFI (B) and finally acquired by another MFI (C). The following chart illustrates the circulation of the bank acceptance.[18]



The outcome is the same as for trade bills. The three parties will record the following positions:

	Presenter principle		Drawee principle	
	With recourse	Without recourse	With recourse	Without recourse
MFI A	Loans to non-MFI X Liability to non-MFI B	Loans to non-MFI X Liability to non-MFI B	Loans to non-MFI X Liability to MFI C	Loans to non-MFI X Liability to MFI C
Non-MFI B	Deposit with MFI A Loans received from MFI C	Deposit with MFI A Loans received from MFI C	Off-balance sheet (commitment to C)	No recording
MFI C	Loan to non-MFI B	Loan to non-MFI B	Claim on MFI A	Claim on MFI A

18 In the case of Germany, a bank acceptance, once discounted by an MFI, would remain in the banking system. Therefore, with reference to Germany, the accounting rules set out in the table are only applicable to MFI (A).

Where the drawee principle is applied, the accepting bank will record both a loan in the asset side and a liability position against the MFI sector. The latter position will be netted out in the consolidated balance sheet of the MFI sector. The non-MFI will record positions only where the presenter principle is applied. The possible distortions are therefore similar to that seen for trade bills.