

Certificates and warrants in the balance of payments

The German market for structured securities¹ has experienced dynamic growth over the past few years. Thus, according to data provided by the German Derivatives Association (*Deutscher Derivate Verband*),² the number of exchange-traded products issued in Germany rose in the course of last year alone from just under 138,000 to almost 300,000.³ The association estimated the market volume of these securities at the end of 2007 at €135 billion.⁴ German banks, in particular, but also, increasingly, subsidiaries of non-resident institutions which do not have their own banking licence and statistically are assigned to the sector German non-banks, act as issuers.

In 2007 German market participants' cross-border activities with these products, which are recorded in the balance of payments, also increased significantly, due mainly to the rise in intra-group transactions by German special purpose vehicles with non-resident parent and affiliated companies. This concerns, first and foremost, trade in structured products, the vast majority of which, as explained below, are classified as debt securities. However, the hedging transactions of German issuers with non-resident counterparties, which protect against the risks resulting from the sale of these securities, also accounted for a considerable amount. As these are generally performed with non-securitised financial futures contracts, they are recorded as derivatives in the balance of payments.

¹ Structured products are created by combining features of various financial instruments (shares, bonds, foreign exchange assets etc) in one single security. The large number of combination possibilities and the use of derivatives can therefore produce investment or speculative instruments that have the widest range of risk-return profiles. In the financial market, structured securities for private investors are often also referred to as certificates. Another important group of structured products are warrants, ie securitised option rights. — ² The German

Recording securities transactions in the balance of payments is more complicated, as the conventional statistical classifications are often not able to provide a suitable representation of the great variety of structured products, especially in the light of the rapid innovation. Since the performance of structured securities depends on the performance of an underlying asset,⁵ these products, from an economic perspective, are derivatives. From a legal perspective, by contrast, they are generally debt securities within the meaning of section 793 of the German Civil Code (*Bürgerliches Gesetzbuch*) because they are bearer securities that certify a payment promise.

The classification in the balance of payments focuses on the legal features of these securities. Cross-border transactions in structured products that fulfil the criteria specified in section 793 of the German Civil Code are therefore classified as debt securities.⁶ Accordingly, structured securities that do not fulfil the criteria specified in section 793 of the German Civil Code are classified as financial derivatives.

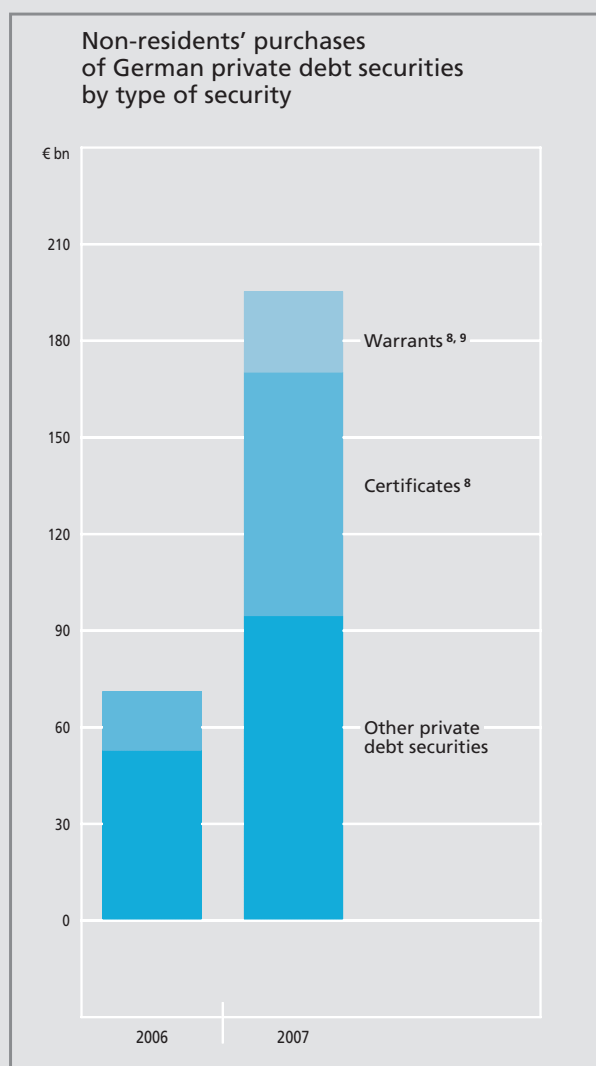
At the beginning of 2007, the strict application of this classification scheme led to a change in the recording of warrants (ie securitised option rights which, as already mentioned, also belong to the group of structured products) in the balance of payments statistics. Up to and including January 2007, warrants had gen-

Derivatives Association was created at the end of 2007 through the merger of the two industry associations Derivatives Forum (Derivate Forum e.V.) and German Derivatives Institute (Deutsches Derivate Institut e.V.). — ³ Levels at the end of 2006 and the end of 2007 (Source: www.deutscher-derivate-verband.de). — ⁴ The market volume is estimated using the open interest (open positions) of the issuers participating in regular surveys. The open interest of an individual security is calculated as the product of the outstanding number of securities

erally been classified in their own subcategory within financial derivatives. However, the Banking Statistics Circular 13/2007 of 27 March 2007⁷ made it clear that warrants also certify a payment promise within the meaning of section 793 of the German Civil Code, if, in accordance with the terms of issue, in the case of a positive value on the maturity date or on the last day of the exercise period, the option right is deemed to be exercised without further action by the holder. As the vast majority of warrants exhibit this feature, virtually all transactions in these securities have been classified as debt securities rather than financial derivatives since February 2007.

In 2007, the above-mentioned activities of market participants had a noticeable impact on the respective balance of payment items, not least on account of the reclassification of warrants. Thus a major part of the increase in non-residents' purchases of German private debt securities from €71 billion in 2006 to €195 ½ billion in 2007 is due to both the growth in purchases of certificates by non-residents (+€57 ½ billion) and the change in the classification of warrants (+€25 billion). As a mirror image of this, German issuers have significantly stepped up their net purchases of foreign financial futures contracts. This has been reflected in the increase in net outflows in the balance of financial derivatives from €6 ½ billion in 2006 to €71 billion in 2007.

and the market price on the reporting date. The individual values are then aggregated to give the open interest of the market as a whole. — 5 The underlying asset can in turn consist of one or more financial market instruments (shares, bonds, foreign exchange assets, indices etc). — 6 Depending on the original maturity, either as money market instruments (less than one year) or bonds and notes (more than one year). — 7 [http://www.bundesbank.de/download/presse/rundschrei-](http://www.bundesbank.de/download/presse/rundschreiben/2007/20070327_rs_13.pdf)



ben/2007/20070327_rs_13.pdf (available in German only). — 8 Securities that were classified as warrants or certificates in the securities database "Wertpapiermitteilungen" and are legally debt securities pursuant to section 793 of the German Civil Code. — 9 Since February 2007 warrants have been classified as debt securities pursuant to section 793 of the German Civil Code if they have the feature of automatic exercise. They had previously been classified as financial derivatives.