IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS

RESERVE ASSETS TECHNICAL EXPERT GROUP (RESTEG)

FOLLOW-UP PAPER (RESTEG) # 11.1

TREATMENT OF ALLOCATED/UNALLOCATED GOLD HELD AS RESERVE ASSETS AND GOLD SWAPS AND GOLD DEPOSITS

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1. At the meeting of May 11–12, 2006, experts of the Reserve Assets Technical Expert Group (RESTEG) discussed the treatment of gold swaps and gold deposits based on the Issues Paper #11. The experts considered that the statistical treatment of gold swaps and gold deposits as reserve assets needed to be addressed from the viewpoint of whether allocated or unallocated gold was involved[1] and the secretariat would investigate the issue further.

2. This follow-up paper was prepared in response to the request of RESTEG, based on further investigation and bilateral discussions with RESTEG members to discover practices on gold transactions, including gold swaps and deposits.

I. CURRENT INTERNATIONAL STANDARDS FOR THE STATISTICAL TREATMENT OF THE ISSUE

3. Current macroeconomic statistics manuals are silent on the statistical treatment of allocated and unallocated gold. There are no explanations on the treatment of gold swaps/ deposits that involve unallocated gold. However, on the statistical treatment of allocated/ unallocated gold, the IMF Committee on Balance of Payments Statistics (BOPCOM) and the Advisory Expert Group on National Accounts (AEG) have discussed and reached agreement at their meetings of June–July, 2005 (BOPCOM), and January–February, 2006 (AEG).

Statistical treatment of allocated and unallocated gold[2]

Allocated gold

4. *Allocated gold* is gold deposited under a safe-keeping or custody arrangement. It is "a specific and uniquely numbered physical piece of gold, which remains in the ownership of the individual or institution placing it for safe custody with a bank" (paragraph 15 of *Philip Turnbull, BOPTEG issues paper # 27A*). The owner of allocated gold keeps legal ownership over the allocated gold even if it is deposited with a custodial facility provider. In the economic system, it remains an asset without a counterpart liability.

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[1] For instance, the meeting was informed that gold swaps primarily involve unallocated gold. Paragraph 100 of the *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template (Guidelines)* states that, "In gold swaps, gold is exchanged for cash and a firm commitment is made by the monetary authorities to repurchase the quantity of gold exchanged at a future date." It seems that the paragraph states only on gold swaps via allocated (physical gold).

[2] For definition of allocated/unallocated gold, please refer to, for instance, *BOPTEG issues paper 27A*. Also, *Non-monetary Gold* (Chris Wright, Stuart Brown, issues paper for the fourth meeting of the AEG) provides a discussion on operation of allocated/unallocated gold accounts (see references at the end of this paper).

Unallocated gold

5. *Unallocated gold* represents a claim on a fixed quantity of gold. "Account providers hold title to a reserve base of physical (allocated) gold and issue claims to account holders denominated in unallocated gold. The account holder does not hold title to physical gold but instead holds an unsecured claim against the account provider, in effect a deposit with the account provider" (paragraph 13 of *Chris Wright and Stuart Brown, issues paper for the fourth AEG meeting*). The account holder does not have legal ownership of the physical gold but is an unsecured depositor. The account holder is a creditor to the account provider, and so in the economic system this asset has a counterpart liability. Unallocated gold targets the professional gold market.

6. In many cases, similar to deposits, an account holder of unallocated gold account deposits its physical gold to its account provided by, for instance, a bullion bank. Then, the account holder undertakes gold transactions (outright purchase/sale, gold swaps, and gold deposits) via the account.[3] But specific gold bars are not ascribed to the holder unless the holder takes delivery of the gold. The bullion bank can use the deposited physical gold for its own trading purpose and so does not necessarily have 100 percent backing in physical gold for the unallocated gold accounts.

Discussion on the statistical treatment of allocated/unallocated gold

7. The AEG agreed at its meeting of January–February 2006 that unallocated gold accounts are to be treated as financial assets, namely, deposits in foreign currency, as agreed by the BOPCOM in its June–July 2005 meeting.

II. Issues to be Discussed Within the Context of Reserve Assets

Treatment of allocated and unallocated gold within reserve assets

8. A monetary authority can own both allocated and unallocated gold.

9. Given agreements at the AEG and BOPCOM, a monetary authority's holding of allocated gold would be monetary gold, as long as all other criteria as reserve assets are met. On the other hand, its holding of unallocated gold would be classified as deposits, rather than monetary gold, even when the other criteria for being classified as a reserve asset are met. However, this latter approach may result in (i) a significant decrease in reported monetary gold, although it would only be a one-off effect, and (ii) gold transactions/positions by monetary authorities would be included within deposits and become difficult to identify.

10. Given the unique status of monetary gold within statistical frameworks, an alternative is to treat unallocated gold the same way as allocated (physical) gold only for reserve assets. The advantages of this approach could be (i) it keeps the *status quo*, (ii) frequent changes in

[3] Also, for example, at the time of opening an unallocated account, the holder can ask a bullion bank to purchase gold from the market and deposit it to their new unallocated gold account.

recorded gold holdings are avoided if central banks switch between allocated and unallocated accounts, and (iii) the complication by residence (how to treat unallocated gold if the account provider is a resident bank) can be avoided. However, this approach would result in an asymmetry in recording between creditors (monetary authorities, account holder) and debtors (bullion banks, account provider) because account providers would record deposited unallocated gold as deposits while monetary authorities would record it as gold. Also, as monetary gold does not have a counterpart liability, whereas deposits do, the inclusion of a claim with a liability (unallocated gold accounts) in monetary gold would cause inconsistencies in statistical treatment, between national accounts and balance of payments.

Gold swaps, gold loans, and gold deposits[4]

11. **From the research undertaken, it appears that a significant portion of, but not all, gold swaps and gold deposits are undertaken via unallocated gold accounts held with metal account providers**. This is because such transactions with allocated gold require physical delivery and/or tracking of specific gold bars and so is very costly. When these transactions are undertaken via unallocated gold, under a gold swap, the owner of the unallocated gold account would swap this unallocated gold claim for cash, to be reversed in a period ahead. A gold loan is similar to a gold swap except that no cash is provided in exchange (paragraph 156 of the *MFSM*). Gold deposits would give the depositor a claim on a fixed quantity, but not specific pieces, of gold.[5] Gold takers of gold swaps/deposits usually make use of the acquired gold for their trading purpose (they may be outright sales or other gold swaps/deposits).

III. POSSIBLE TREATMENTS

Treatment of allocated and unallocated gold in reserve assets

12. Allocated gold is physical gold and, therefore, as long as it meets the criteria as reserves, is classified as monetary gold under reserve assets.

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[4] The IMF's *Monetary and Financial Statistics Manual* (*MFSM*) states that "*Gold swaps* are forms of repurchase agreements commonly undertaken between central banks and other 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" (paragraph 154; see also paragraph 100 of the *Guidelines*). Also, "*Gold loans* (or gold deposits) may be undertaken to obtain an income return on 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" (paragraph 156 of *MFSM*), and "In reserves management, it is common for monetary authorities to have their bullion physically deposited with a bullion bank, which may use the gold for trading purposes in the world gold markets" (paragraph 99 of the *Guidelines*).

[5] Difficulties in terminology arise. In the *Guidelines*, and in the Eurosystem's definition of international reserves, gold deposits and gold loans are considered synonymous (*Guidelines*, paragraph 98), but with unallocated gold accounts, the term "deposits" is used in the more conventional sense. The use of terminology will need to be reviewed.

13. **Unallocated gold could be treated as deposits and included in reserves if the deposit meets the criteria of reserve assets (including being a claim on a nonresident). This approach is consistent with treatment of unallocated gold held/transacted as other than reserves, as agreed by AEG and BOPCOM.** In this case, as stated in paragraph 9, monetary authorities' transactions/positions of unallocated gold would be included in deposits.

14. **Alternatively, for reasons described in paragraph 10, unallocated gold held by monetary authorities that meets the criteria of reserve assets; that is, is readily available, could be treated as gold, rather than deposits, i.e., *status quo.*[6]** To reconcile asymmetrical recording between creditors and debtors, and inconsistency between gold with and without corresponding liabilities, transactions/holdings of unallocated gold within gold would need to be identified (including a breakdown between claims on residents and nonresidents). One possibility could be to change the heading of monetary gold in the standard components to "gold holdings" with subheadings of "monetary gold" and "other gold." The standard component of balance of payments and international investment position (IIP) would be:

4.1 Monetary gold ⇨ 4.1 Gold holdings
4.1.1 Monetary gold
4.1.2 Other gold
— Claims on resident banks
— Claims on nonresident banks

15. Unallocated gold held by the monetary authorities that does not meet the criteria of reserve assets would be treated as deposits, i.e., other investment of the monetary authorities in the balance of payments and IIP if a claim is on a nonresident, otherwise as a claim on a resident bank.

Gold swaps

16. The treatment of gold swaps needs to be considered in the context of the discussion on repos/reverse repos,[7] taking into account the nature of allocated gold and unallocated gold as instruments. The statistical treatment of reverse transactions in reserves (repo and reverse repo) is still being discussed. There are two alternatives: (i) excluding securities out on repo from reserve assets and reclassifying them as portfolio investment assets, given that it is unlikely that they will be readily available upon demand, and (ii) keeping securities out on

[6] As agreed by RESTEG (see (3) (iv) of the *Outcome Paper (RESTEG) #11*), if the deposited gold is available upon demand to the monetary authorities, it can be included in reserve assets as monetary gold (paragraph 99 of the *Guidelines*).

[7] *Balance of Payments Manual*, fifth edition (*BPM5*) does not clearly state that gold swaps are reverse transactions (see paragraph 434). On the other hand, other publications such as the *Guidelines* (paragraph 101), *MFSM* (paragraphs 154, 157, and 158), and the Eurosystem's definition of international reserves regard gold swaps as reverse transactions. So, there is a need for clarification.

repo within reserve assets but including the repo loans in reserve-related liabilities (RRL).[8] On reverse repos, the securities acquired via reverse repos would not be included in reserve assets.

17. Statistical treatment of gold swaps[9] could be as follows:

(1) ***Allocated gold***

(a) exclude gold out on swap from reserve assets and demonetize[10] the gold, i.e., the gold swapped would also be excluded from the financial assets of the monetary authorities—similar to treatment 15(i) for repos, or

(b) include gold out on swap in reserve assets as monetary gold and record the swap loans in RRL, if with a nonresident—similar to treatment 15(ii) for repos.

(2) ***Unallocated gold***

(a) The statistical treatment would be either (i) or (ii) below, according to treatment of repo/reverse repo (if agreed as suggested in paragraph 13);

(i) exclude unallocated gold (deposits) out on swap from reserve assets and reclassify it as other investment of the monetary authorities, if a claim on a nonresident, or

(ii) include unallocated gold out on swap in reserve assets as deposits and record the swap loans in RRL, if a claim on a nonresident, or

(b) when unallocated gold is treated as suggested in paragraph 14;

(i) exclude unallocated gold (gold) out on swap from reserve assets and reclassify it as other investment of the monetary authorities, if a claim on a nonresident, or

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[8] The possible introduction of RRL into the BOP framework remains under discussion. But even if adapted the approach under 16(ii) would give rise to an overestimation of net reserves when the swap is done with a resident, since RRL would only include liabilities with nonresidents.

[9] Gold loans would be treated similarly except no cash is provided in exchange.

[10] This arises from the special nature of gold within the statistical framework, i.e., ownership of allocated gold either as monetary gold, as a financial instrument, or as goods (non-monetary gold). On the other hand, regarding reverse transactions undertaken through foreign securities (such as repo and reverse repo), such securities are included in IIP, reclassified from reserve assets to portfolio investment of the monetary authorities. See footnote 2 of Issues Paper #8. Also, see paragraph 8 of Issues Paper #11.

(ii) include unallocated gold out on swap in reserve assets as monetary gold and record the swap loans in RRL, if a claim on a nonresident.

18. Another issue that needs to be considered on gold swaps undertaken via unallocated gold accounts is how the account provider (a bullion bank) records the transactions for statistical purposes.

19. As the *Guidelines* describe, monetary authorities may undertake gold swaps (paragraph 100). So, assume that a central bank (A) holds an unallocated gold account in bullion bank (B) with a position of 100, and undertakes a gold swap of 100 with a financial institution (C) (perhaps by asking B to undertake the transaction on its behalf). If the statistical treatment is that the ownership of the underlying asset is assumed not to change hands under a gold swap, central bank A continues to report, a holding of unallocated gold (100) as reserve assets or other investment and C does not record, a holding of unallocated gold (100). On the other hand, bullion bank B has legal liability of 100 to C and may record deposit as from C. So, both A and C may record a gold holding (A may keep recording on a claim on B, while C may record its claim on B). This situation is the same as occurs for securities under repos, except that in this instance a deposit with a bank in involved rather than a security.

20. If market practice is for B to record that C not A has ownership then de facto it places in question whether gold swaps with unallocated gold should be treated like repos, although the economic ownership argument may be equally as valid. So, in order to determine appropriate treatment, practices of market and accounting of banks on gold swaps need to be taken into consideration. But, as stated in paragraph 100 of the *Guidelines*, accounting practices of gold swaps vary among countries.

Recording of gold arising from outright sales of gold acquired through gold swaps/loans

21. The assumption above is that gold swaps/loans are treated like repos and gold takers do not record gold acquired under swaps/loans in their balance sheet (see paragraph 101 of the *Guidelines*, and paragraphs 155 and 156 of *MFSM*).

22. Given this, when the gold swapped/loaned is sold outright and the transaction is in an **unallocated account**, the following treatments are proposed:

- If the seller is a monetary authority, the seller should record on its balance sheet negative position in deposits or gold.

  (a) If the purchaser is a monetary authority, the purchaser records an increase in deposits or gold;

  (b) If the purchaser is a non-monetary authority, the purchaser records an increase in an unallocated gold accounts.

- If the seller is a non-monetary authority and the purchaser is a monetary authority, then the non-monetary authority records a short position in the unallocated gold account (i.e., deposits). If the gold is acquired via gold swaps/loans by a monetary authority and the monetary authority keeps the gold in its balance sheet, the same holding of gold would be reported on the balance sheet of two monetary authorities at the same time, with the non-monetary authority recording a short position.

23. Similarly, if the gold acquired via gold swaps/loans is sold outright and the transaction is in an **allocated account**, the following treatments are proposed (see paragraph 155 of *MFSM*);

- If the seller is a monetary authority, the seller should record on its balance sheet negative position in gold.

  (a) If the purchaser is a monetary authority, the purchaser records an increase in gold;

  (b) If the purchaser is a non-monetary authority, a demonetization will be involved.

- If the seller is a non-monetary authority and the purchaser is a monetary authority, **a monetization** will be involved. This could create the situation where monetary gold is overstated if the gold is acquired via gold swaps/loans by a monetary authority and the monetary authority keeps the gold in its balance sheet, in as far as the same holding of gold would be reported on the balance sheet of two monetary authorities at the same time.

IV. Questions to RESTEG

(1) Do RESTEG members prefer to classify unallocated gold accounts held as reserves either as (a) deposits, as with other unallocated gold accounts (paragraph 13), or (b) as gold with the corresponding change to the standard components as set out in footnote 7 (paragraph 14)?

(2) If (b), would RESTEG members support identification within other gold of (i) resident, (ii) nonresident banks to ensure consistency with national accounts? Are there other proposals to ensure such consistency?

(3) What are RESTEG members' preferred approach for gold swaps for (i) allocated gold, (ii) unallocated gold (paragraph 17)? Also, based upon the knowledge of market practices on gold swaps in members' countries, what are the members' views on the issues in paragraphs 18–20?

(4) Do RESTEG members agree with the description of the transactions set out in paragraphs 22 and 23?

References

Balance of Payments Manual, Fifth Edition, paragraph 434

International Reserves and Foreign Currency Liquidity, Guidelines for a Data Template, paragraphs 98–101, 178, 258

Monetary and Financial Statistics Manual, paragraphs 154-164

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