**IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS**

**RESERVE ASSETS TECHNICAL EXPERT GROUP (RESTEG)**

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# ISSUES PAPER (RESTEG) # 5

## INVESTMENT FUNDS

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## BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP

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## INVESTMENT FUNDS

1. The continued accumulation of international reserves in some countries has renewed country interest in the creation of long-term investment funds in their different modalities, similar to those created by oil producing countries in last decades, for stabilization and/or intergenerational wealth purposes, or such like. The issue has arisen over the classification of foreign assets that are part of a long-term investment fund, specifically whether these should be included in reserve assets, or not.

2. When the authorities create a long-term investment fund the perception is that the objective is oriented to "return" over the longer term rather than "liquidity" for balance of payments needs. The core issues regarding classification of assets within reserve assets remains the same as with any other asset: does the monetary authorities have effective control over the foreign assets of the investment funds so they can be readily available to meet a balance of payments financing need.

### I. Current international standards for the statistical treatment of the issue

3. The fifth edition of the *Balance of Payments Manual (BPM5)* and the *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template* (*Guidelines*) do not discuss such funds. However key issues that help determine if foreign assets can be considered international assets are:

(a) Do they meet the criteria as stated in paragraphs 65 of the *Guidelines*? "Reserve assets are, first and foremost, liquid or marketable assets readily available to the monetary authorities."

(b) Are they foreign currency claims on nonresidents as mentioned in paragraphs 66 and 69 of the *Guidelines*? "Reserve assets must be foreign currency assets" (paragraph 66). "In accordance with the residency concept, in the *BPM5,* "external" assets refer to *claims of the monetary authorities on nonresidents*. Conversely, *the authorities' claims on residents are not reserves assets"* (paragraph 69).

(c) Are the assets under the effective control of and readily available to the monetary authorities to meet a balance of payments financing need? "Underlying the *BPM5* concept of reserves are the notions of "effective control" by the monetary authorities of the assets and the "usability" of the assets to the monetary authorities" (paragraph 65 of the *Guidelines*).

4. Paragraph 428 of *BPM5* mentions that “The aspect of control can be appraised only with reference to the institutional framework in individual economies...,” and makes reference to two extremes that can best define the effective control of the monetary authorities. In the narrowest sense, monetary authorities control absolutely only those assets to which they legally hold title. On the other hand, almost any asset owned by a resident of the economy may ultimately be subject to the control of the authorities.

5. Both *BPM5* and the *Guidelines* are very clear in stating that the assets should be readily available in the most unconditional form to be considered part of official reserve assets.

## II. Issues arising from the current treatment of foreign currency

6. There is no reference to assets held in investment funds in *BPM5* or the *Guidelines,* and while the core concepts can be applied, as these funds become more prevalent additional guidance is required. Further the establishment of investment funds has raised the issue of the relationship between control and ready availability to the assets to meet a balance of payments financing need. In this regard, the institutional arrangements are relevant in determining if foreign assets held in the investment funds by the authorities are reserve assets.

7. Based on the current treatment in both *BPM5* and the *Guidelines*, it has been understood by Fund staff that if the foreign assets are on the books of the central bank, and they or an agency of the central government is able to control the investment strategy, which so allows control over the disposition of funds, then the *presumption* is that the assets are international reserves (provided all other criteria for being a reserve asset are met).

8. It is also important to be aware that the concept of monetary authorities is not limited to just the central bank. Certain operations usually attributed to the central bank but sometimes carried out by other government institutions are also covered, (paragraph 21 of the *Guidelines* states that “ Consistent with *BPM5* (paragraph 514), the template defines *“monetary authorities” as “a functional concept” encompassing the central bank* (and other institutional units such as the currency board, monetary agency, etc.) *and certain operations usually attributed to the central bank but sometimes carried out by other government institutions or commercial banks...”*). So foreign currency assets owned by the government can be included in reserve assets.

9. If the assets are owned by the government directly, or the central bank, then it is relevant to know the institutional arrangements for drawing down these funds. If the investment fund assets are encumbered in a way that precludes their ready availability to the monetary authorities to meet a balance of payments financing need, then they should be excluded from international reserves.[1] On the other hand if there is no such preclusion, they

[1] Similarly, paragraph 72 of the *Guidelines* considers that “if clearly not readily available, pledged assets should be excluded from reserves.”

should be included. Due to the lack of clear guidance, this case seems the most difficult to interpret in the absence of a clear understanding of the institutional arrangements. The main determination used in previous advice rested on whether there is some legal or administrative guidance that determines the fund's investment strategy and limits the ready availability of the funds to the monetary authorities to meet a balance of payments financing need. Making such a determination is essential to determining the recording treatment of foreign assets held in investment funds.

10. For instance, the possible use of the stabilization/wealth funds in many, but not all, cases is circumscribed by law or other high level regulation. That description contains the information necessary to determine how the funds can be used. Thus often the funds can only be disbursed when there is a budgetary need, or using specific distribution formulae (e.g. x% of assets can be distributed annually), or if trigger criteria are fulfilled (e.g. an oil price below z). Such restrictions rule out the ready availability of the assets to meet any type of balance of payments financing need.

11. For those cases in which the creation of a long-term investment fund involves a portion of reserves being transferred to a new investment corporation, separately incorporated, the *presumption* is that they should no longer be considered reserve assets. Part of the explanation for not considering these resources reserve assets any more is that it is difficult to argue that these resources will be readily available to the monetary authorities to meet a balance of payments financing need.[2] But these are *presumptions* and as with treatment of pooled asset arrangements (discussed in Issues Paper 6), a close examination of the legal and institutional arrangements is needed for each case, rather than decided *a priori.* As above and with pooled assets, the basic criteria remains whether the assets in the investment fund are readily available to the monetary authorities to raise external liquidity to meet balance of payments financing needs of any type.

12. Another important consideration is that the transfer of reserves to the investment fund could mean that the claims of the central bank or government are on the investment fund. In such circumstances, the foreign currency transferred may be reinvested in domestic assets. In making a determination whether claims on a nonresident investment fund should be classified as reserve assets or not, a clear picture is needed of how the "transfer" takes place if it is indeed a loan or a sale of securities and/or currency, and whether the investments of the investment fund are concentrated in claims on the domestic economy or in the domestic currency, or not (see also Issues Paper 6).

13. Paragraph 429 of *BPM5* concludes that ownership is not a necessary condition for control. Paragraph 435 elaborates further noting that for those assets that are not actually owned by monetary authorities "...Nevertheless, the possibility that such assets may qualify (as reserve assets) cannot be entirely precluded...if monetary authorities are presumed to be exercising effective control over such assets, the assets must possess quite distinctive

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[2] Of course if the assets were transferred over to the central bank, the classification could change.

characteristics...” On the same line, paragraph 68 of the *Guidelines* goes further in mentioning that in cases where institutional units (other than monetary authorities) in the reporting economy hold legal title to external foreign currency assets and are permitted to do so only on terms specified by the monetary authorities or only with their express approval, such assets can be considered reserve assets (see also Issues Paper 7, which discusses the same issue with regard to foreign assets owned by resident banks).

## III. Possible treatments

14. The new *Manual* could adopt the *Guidelines*’ wording on the key criteria to determine if the foreign assets in long-term investment funds can considered reserve assets. These criteria are the same as for any asset, including being foreign currency assets that are readily available to meet a balance of payments financing need.

15. Nonetheless, some further guidance on the treatment of assets held in investment funds could be added. This text would cover the issues discussed in paragraphs 7 to 13 above including on whose books the assets are held, emphasizing the importance of any specific legal or administrative impediments to using the assets of these investment funds to raise external liquidity to meet a balance of payments financing need. Ready availability to use the assets for balance of payments financing of any type, as opposed to use under restrictive conditions, is the most important demonstration of de facto control by the monetary authorities. Resources that are encumbered should not be part of reserve assets, even if, say, the central bank is the asset manager of the funds.

16. Also to support transparency, the IIP could also include as a memorandum or supplementary item the data on those foreign assets of the authorities that are not part of international reserves but are owned by long-term investment funds created by the government.

## IV. Points for discussion

- *Do group members support the proposals in paragraphs 14-16, in particular is the emphasize on whose books the assets are held and the ready availability of the assets to meet a balance of payments financing need appropriate?*

- *Do group members agree on the relevance of institutional agreements to determine if foreign assets held in the investment funds by the authorities are reserve assets?*

- *For assets held in separately incorporated long-term investment funds (paragraphs 11, 12 and 13), in the experience of RESTEG members are there conditions under which the assets could be included in reserve assets? If so, which conditions are these? If the claim is on the investment fund, are the conditions equivalent to those discussed with regard to pooling arrangements (Issues paper 6)?*

- *Are there other issues relating to investment funds that need to be considered?*

**References**

*BPM5*, paragraphs 428, 429, 435, 514
*Guidelines*, paragraphs 21, 65-67, 69, 72
*Annotated Outline*, paragraph 5.54