IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS

RESERVE ASSETS TECHNICAL EXPERT GROUP (RESTEG)

ISSUES PAPER (RESTEG) # 8

TREATMENT OF REVERSE TRANSACTIONS

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TREATMENT OF REVERSE TRANSACTIONS

1. Because of the conceptual approach to the treatment of reverse transactions in maco-economic statistics, it is important in compiling reserves data to avoid overstating a country's foreign currency liquidity position. The *Guidelines* specify two approaches for dealing with this concern, but given the experience since the *Guidelines* were introduced this paper proposes a single approach.

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

2. The conceptual treatment of reverse transactions is set out in paragraph 418 of *BPM5* when describing the approach to repurchase agreements (repo).[1] This paragraph states that the economic nature of a repo is similar to that of a collateralized loan. Consequently, as practice has emerged, while ownership of the securities change hands, the lender (security provider) and not the borrower (cash provider) keeps these securities on their balance sheet during the life of the repo, with transactions recorded in cash and loan liabilities/assets.

3. The *Guidelines* follow the advice in *BPM5* but in paragraph 85 notes the importance of avoiding overstating the liquidity position, as both the funds received and the securities repoed remain with the security provider. Paragraph 85 provides two alternative treatments for both those monetary authorities under taking repo transactions.

4. For repos, paragraph 85 (i) states that the security provider should record the funds received as an increase in deposits among reserve assets, and the securities provided removed from reserve assets;[2] while the alternative in paragraph 85 (iii) allows both the funds and the securities to be recorded as reserve assets but requires the recording of a predetermined drain in Section II. 3 relating to when the repo matures and the cash is to be returned.

5. For reverse repos, paragraph 85 (ii and iv) states that the funds provided reduces reserve assets and the securities acquired are to be shown in Section IV (1) (d), "borrowed or acquired but not included in Section 1." If the reverse repo claim (repo asset) is liquid and available on demand the decline in deposits should be counterbalanced by a recording of the repo asset in reserve assets (under 1.A (5), other reserve assets) (paragraph 85 (ii)), and if the repo claim is not liquid, a future predetermined inflow associated with the return of the securities should be recorded in section II.3 (paragraph 85 (iv)).

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[1] Reverse transactions cover both repurchase agreements, under which securities are provided in return for cash, and securities lending under which securities are provided, for a fee, but no cash is provided in return.

[2] In the IIP, such assets would be reclassified to portfolio investment as they remain on the balance sheet of the security provider.

6. For security lending, the *Guidelines* consider that the same treatments as for repos should be applied (paragraph 88).

II. Issues arising from the current treatment of reverse transactions

7. Paragraphs 85 (i) and 85 (iii) give two different treatments for classifying repo transactions. The guidance of paragraph 85 (iii) overstates reserve assets because both the funds received from the repo and the security assets are included in reserve assets. While the security assets are out on repo, it cannot be the case that both the funds and the securities are simultaneously liquid and readily available to the monetary authority, as the cash would have to be returned when the repo matures (or is called early).

8. The *Guidelines* provided alternative treatments because the accounting practices differed among countries (see paragraph 84). This paragraph explains that some countries record repos as transactions in securities, in which the securities are deducted from the balance sheet and the funds acquired are added to the balance sheet. Other countries do not deduct the securities of the balance sheet; they show the funds obtained from the repo as an asset counterbalanced with a liability for the funds acquired.

III. Possible treatments

9. First, the treatment in the reserves data of reverse repos, funds acquired under repos, and collateral loans should be made explicit in the new M*anual.*[3]

10. Second, in order to avoid double counting of the security and the funds raised through the repos, the securities involved in the repo agreements should not be included in reserve assets, that is for repos, the new *Manual* should recommend the approach in 85 (i). This should give for a uniform treatment of transactions and improve international comparability of reserve data among countries.

11. Third, the treatment in reserves of transactions relating to reverse repos should be as set out in paragraph 85 (ii) and 85 (iv) depending on whether the repo asset is liquid and available on demand, or not.

12. Four, the same treatments as set out in paragraphs 10 and 11 above should be applied to securities lent/borrowed with other securities used as collateral and no cash is exchanged (paragraph 88 of the *Guidelines*). However, the views of TEG members are welcome on whether there are cases where for the security provider the securities might be readily available, if the securities loan is callable at very short notice.

[3] In the *Guidelines*, gold swaps are treated similarly to repos and reverse repos (paragraph 101). It is proposed that a separate paper be drafted on this topic, and the related issue of gold deposits, after the Advisory Expert Group on the National Accounts has discussed the paper, "financial asset classification: financial gold" at its January/February 2006 meeting.

13. Five, the new *Manual* could also discuss the cases where repos and reverse repos involve securities that do not meet the criteria to be classified as reserve assets, but the funds involved do e.g., they are dollar assets.

IV. Points for discussion

14. Are the proposals set out in paragraphs 9-13 acceptable?

15. Could securities loan arrangements be callable at such short notice that the securities provided could be considered readily available?

References

BPM5, paragraph 418

Guidelines, paragraphs 85-88

Annotated Outline, paragraph 5.51 (c)