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**Report of the Technical Group on Third Party Holdings**

**Prepared by the Technical Group on Third Party Holdings**

# REPORT OF THE TECHNICAL GROUP ON THIRD PARTY HOLDINGS

## I. INTRODUCTION

A Technical Group on Third Party Holdings (TGTPH) was established by the IMF Committee on Balance of Payments Statistics (the Committee) in October 2000, to determine the feasibility of developing partner country sources for securities held with nonresident custodians as a means of addressing gaps in collection systems used for the Coordinated Portfolio Investment Survey (CPIS).

The terms of reference of the Technical Group on Third Party Holdings (TGTPH) are:

- to explore ways of filling gaps in the standard collections of data on resident holdings of securities, on a ultimate beneficial owner (UBO) basis, that are held in custody outside the country of residence of the investor, to see whether or how data on these securities, broken down by country of residence of issuer and country of residence of holder, can be captured;
- while taking into account the chains of custody and reverse transactions that may obscure the UBO, and specifically; and
- to assess whether custodians are able to provide information on a subgroup of third party holdings, namely, high worth individuals, that is unlikely to be captured in other ways.

The TGTPH reported to the Committee at its 2002 meeting (BOCOM-02/12). This report provides an update of the technical group's work since then, and sets out proposals for further work.

## II. BACKGROUND

CPIS participants collect their data in one of more of the following ways:

- end-investor survey only
- custodian survey only
- combination end-investor and custodian survey (designed to avoid double counting)

In principle, **end-investor surveys** capture all of the data required for the Coordinated Portfolio Investment Survey (CPIS) on residents' holdings of securities issued by nonresidents. However, in practice, there may be several reasons why this does not occur.

Among the principal reasons for this failure for an end-investor survey to obtain all the data are:

- an incomplete survey frame
- a response rate of less than 100 percent
- no survey of households.<sup>1</sup> (No jurisdiction conducts a direct survey of households so the size of this omission is unknown, but it may be substantial in certain jurisdictions.)

On the other hand, while a **survey of custodians** will address most of the shortcomings of an end-investor survey, it will miss securities:

- held in investors' own custody
- held in custody outside the country.

It also poses problems for the correct measurement of securities involved in reverse transactions

A **combination of an end-investor and custodian survey** will overcome many of the problems when one or other of an end-investor or custodian surveys is conducted without the support of the other, it still leaves gaps that result from

- an incomplete survey frame and
- to the extent that entities, especially households, not captured in the end-investors' survey frame hold securities in their own custody or with custodians abroad.

It was to address these problems that the TGTPH undertook visits to various custodians and examined alternative courses of action.

### III. VISITS TO EUROCLEAR AND CLEARSTREAM

Following on the discussions held with custodians in the United States and the United Kingdom (as reported to the Committee in BOPCOM-02/12), the TGTPH held meetings in 2003 with Euroclear (in Brussels) and Clearstream (in Luxembourg) to determine to what extent, if at all, either body was able to provide information on the beneficial owner of the securities they hold as central depositories.

These two agencies were very helpful in discussing the nature of the operations. For the most part, they operate as central depositories, and provide financing to their members, to ensure smooth operations and settlements in the securities transactions that are conducted through their organizations. Nearly all their members are banks, but there are a few nonbanks,

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<sup>1</sup> *Households* should be taken to include unincorporated businesses, trusts, estates, and nonprofit institutions serving households (NPISHs).

notably large financial institutions that have important securities operations. Only members can use the trading facilities in both organizations. Neither Euroclear nor Clearstream, generally, is in a position to identify the UBO. Although there are a few instances where such information might be provided, for the most part, this information is not made available to them.

#### IV. POSSIBLE COURSES OF ACTION

In view of the foregoing, the TGTPH felt that there were four possible options for obtaining the information on third party holdings (TPH) from resident custodians:

1. Obtain data on securities issued by nonresidents, that they hold on behalf of **all nonresidents**, by country of holder and country of issuer;
  - 1a. Obtain data on securities issued by nonresidents, that they hold on behalf of **high worth nonresident individuals**, broken down by country of holder and country of issuer;
2. Obtain data on securities issued by residents of all countries, that they hold on behalf of **all nonresidents**, broken down by country of holder and country of issuer. This approach differs from Option 1 in that it includes issues by residents. In other words, this approach would represent, at least, in part, a liabilities, as well as an asset, survey.
  - 2a. Obtain data on securities issued by residents of all countries, (including those issued by residents), that they hold on behalf of **all high worth nonresident individuals**, broken down by country of holder and country of issuer;
3. Obtain data on all the securities they hold, **regardless of the residence of the investor**, broken down by country of holder and country of issue. This option differs from Option 2 in that it includes resident:resident relationships.

Both option #1 and #1a would omit some (possibly substantial) bilateral liabilities/assets, and, as such, would be of only limited value. The TGTPH, therefore, does not recommend pursuing these approaches.

The TGTPH felt that the other three options offered potentially considerable benefits. The advantage of Option #2 is that it covers all holdings for all nonresidents. As a result, any information that might be missed by the compiler in the CPIS (be it an end-investor survey, a custodian survey, or a combination of these) could be identified. To ensure that this information were usable by counterpart jurisdictions, in compiling their CPIS results, to avoid double counting, these CPIS compilers would need to design their end-investor surveys

so that securities these end-investors held in custody with nonresident custodians were identifiable.<sup>2</sup>

Option #2a is a simpler approach, as custodians can usually more easily identify these holdings. Moreover, the results could be more readily used by counterpart CPIS compilers in that it is a reasonable assumption that the information of high worth individuals is not reported in any end-investor survey, and, by definition, is not covered in a resident custodian survey. However, this approach may be more expensive for custodians to provide if they do not maintain a separate database for high worth individuals.

Option #3 is the most comprehensive exercise, and may be the simplest for custodians to provide: all they need to do is provide a “dump” of their holdings. In that way, the matrix of holders by country of residence of issuer could be most readily reported. However, it may be that custodians are not prepared to release such information, and it is also probable that many compilers would not be in a position to make use of the data, unless they have well enough developed computer systems that could handle such a wealth of information. Given the weakness of prices information that is often found with custodian reporting, this approach would probably require security-by-security reporting.

An additional consideration, which is not solely applicable to a TPH survey—it applies to all custodian surveys—is how to ensure that the custodians report the UBO correctly. There are two primary concerns. The first is the chain of custodians. For a TPH survey to report the UBO correctly, it would be essential that only one custodian provide the information, the one with the closest relationship, and knowledge of, the end-investor. Where, for example, a global custodian in Country X, acting on behalf of a high worth individual, who is a resident of Country Y, places securities with a local custodian in Country Z, it would be necessary that the custodian in Country Z did not report its holdings on behalf of the resident of Country Y: that information should be reported by the custodian in Country X. The reporting instructions for the TPH survey in both Country X and Country Z would need to explain clearly which custodian is to report the holdings of the resident of Country Y. The second concern is with regard to reverse transactions, specifically, repurchase agreements (repos) and securities lending. As is evident from the results of the survey on reverse transactions (see BOPCOM-03/12), custodians frequently are unaware that a reverse transaction has occurred. This issue, however, may be less important for high worth individuals as they are not very likely to be involved in repos. However, high worth individuals may have agreements with their custodians to permit the custodian to undertake securities lending. This may cause measurement problems because, whereas the “lending” custodian should be able to identify what it has “lent”, the custodian for the “borrower” may not know that the

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<sup>2</sup> If this approach were pursued, extra caution would be required for aggregate end-investor surveys as the valuation principles may be inconsistent between those used by the end-investor and those reported by the custodian. Any derived differences between the values reported by end-investors of their holdings with nonresident custodians and the values, for the counterpart country, reported by custodians in a TPH survey could not necessarily be assumed to be undercoverage of the end-investor survey, as a result..

securities have been “borrowed”. However, this problem is not restricted to TPH: it is a problem with any custodial reporting (see BOPCOM-03/12)

In Table 1, the items shown with an asterisk indicate the information on nonresident households’ holdings of securities held by resident custodians. This information could be provided using Options #2, #2a, or #3. The TGTPH considers that it would be only necessary to approach major financial centers to obtain these data as it feels that TPH is highly concentrated in those centers.

Any further work on third party holdings should, therefore, be aimed at custodians in major financial markets, and is predicated on the assumption that households’ holdings are identifiable separately, at least at some point along the chain (and at only one point). This would need to be confirmed before any survey were to be attempted. Similarly, the legal authority for collecting the information would also need to be ascertained. Voluntary surveys in this area may prove problematic. Further discussions should be undertaken with national authorities in jurisdictions likely to be important centers for TPH.

In light of the foregoing, the TGTPH considers that Options #2 and #2a should be pursued further (Option #3 is felt to be too ambitious at this stage, and Options #1a and #1b would omit too much important information). The TGTPH proposes this course of action because Options #2 and #2a would provide much valuable information that would be readily usable by counterpart compilers, even if not all of the major financial centers participated: the data from these options on households’ holdings would be net additional information —over and above present sources of information. (and, if sufficient detail to remove any double counting, for other sectors’ holdings as well, under Option #2). Accordingly, the TGTPH proposes a pilot study of some of the major economies where cross-border custodial activity is likely to be high. The TGTPH feels that it may be inappropriate to approach more than a few jurisdictions at this point as:

- (a) several of the potential participating jurisdictions in any third party holding (TPH) survey may be reluctant to participate without a demonstration that the exercise can be useful; and
- (b) obtaining liabilities data (which is implicitly covered in Options #2 and 2a) may lead to the perception by some jurisdictions that it might reveal information on sources of funds that participants may be reluctant to identify. In due course, this problem may be overcome in much the same fashion that sensitivities on country breakdown of reserve assets are addressed in the Coordinated Portfolio Investment Survey —via the use of a simple vector of all holdings so that no one jurisdiction’s holdings are identifiable.

Accordingly, if the Committee agrees that further work should be undertaken, the TGTPH suggests that the next step be the design of a (simple) questionnaire, seeking information on what custodians maintain on their databases (such as whether their records on individuals are maintained separately) and then approach some national authorities to see whether they

would be prepared to participate – at least in asking the information. At the same time, the TGTPH will need to find out what legal hurdles there might be for these national authorities to collect the information on TPH.

**Table 1. Summary of Missing Information<sup>3</sup> and How It Might be Obtained**

<b>Approach</b>	<b>Missing information</b>	<b>How to capture missing information</b>
End-investor survey only	<b>Households holdings:</b> - with <b>resident custodians</b>  - with <b>nonresident custodians</b>  - in <b>own custody</b>  <b>Other end-investors not surveyed holdings:</b> - with <b>resident custodian</b>  - with <b>nonresident custodian</b>  - in <b>own custody</b>	Resident custodial reporting  *Nonresident custodial reporting  Essentially unobtainable (possibly significant in some countries)  Extend survey coverage/ Resident custodial reporting  Extend survey coverage/ Resident custodial reporting /*Nonresident custodial reporting  Extend survey coverage
Custodian survey only	<b>Households with nonresident custodians</b>  <b>Households own custody</b>  <b>Other end-investors with nonresident custodians</b>  <b>Other end-investors own custody</b>	*Nonresident custodial reporting  Essentially unobtainable (possibly significant in some countries)  Extend survey coverage/ *Nonresident custodial reporting  Extend survey coverage
Combination of end-investor survey and survey of custodians	<b>Household holdings:</b> - with <b>nonresident custodians</b>  - in <b>own custody</b>  <b>Other end-investors not surveyed</b> - with <b>nonresident custodians</b>  - in <b>own custody</b>	*Nonresident custodial reporting  Essentially unobtainable (possibly significant in some countries)  Extend survey coverage/ *Nonresident custodial reporting  Extend survey coverage

\* Indicates where a survey of third party holdings could be used to fill the gap for household holdings.

<sup>3</sup> Holdings of securities by country of nonresident investor, by country of residence of issuer, by type of investment, on an SBS basis. SBS reporting by custodians is probably necessary as the quality of information, if custodians reported on an aggregate basis, is likely to be of inadequate quality.

***Questions for the Committee***

1. *Does the Committee agree with the TGTPH's proposal to pursue further a survey of custodians in major financial centers on their holdings of securities held on behalf of nonresidents?*
2. *If the Committee endorses the proposal, does it have a view on which option should be pursued?*