BOPCOM-05/70

Eighteenth Meeting of the
IMF Committee on Balance of Payments Statistics
Washington D.C., June 27–July 1, 2005

Revision of *BPM5*: Issues on International Reserves

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REVISION OF *BPM5*: ISSUES ON INTERNATIONAL RESERVES

I. INTRODUCTION

1. Within the context of the current revision to the fifth edition of the *Balance of Payments Manual (BPM5)* and its framework document, the *Annotated Outline* (*AO*) of April 2004, this paper aims to raise some issues on international reserves, providing some indications as to the way forward, and proposing the creation of an *ad hoc* technical group to discuss international reserve issues. We propose to update *BPM5* for changes introduced in the data template on international reserves and foreign currency liquidity (Data Template), and to take account of and discuss issues that have arisen since its implementation. Further, the revision to *BPM5* will warrant a revision in parallel of the *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template (Guidelines),* although there is no intention to change the Data Template.

2. Some of the issues raised in the paper are drawn from the outreach seminars in 2004 and 2005 on international reserves that the IMF's Statistics Department (STA) has undertaken in different regions. The seminars have provided a venue for country experts to review experiences in compiling the template data, to understand and attempt to resolve outstanding issues, and to improve the coverage and accuracy of the data.

A. Background

3. In its Chapter 5, section 5.46 – 5.62, the *AO* includes the key issues on international reserves to be considered for the review. This section reflects the macroeconomic statistical aspects that are suggested to be considered in the new economic developments and economic analysis needs since the publication of *BPM5* in 1993. Data deficiencies, as revealed by the financial crises of the 1990s, have stimulated the need for clearer dissemination standards and comprehensive methodological guidelines on international reserves. These needs were addressed with the introduction of the Data Template in 2000 as a new requirement of the Special Data Dissemination Standard (SDDS) and with the publication of the *Guidelines.* However, based on the experience since *BPM5* was finalized and particularly after the implementation of the Data Template six years ago, the update to the international reserves section of *BPM5* is fully justified.

B. Structure of the Paper

4. Section II on methodological issues includes both the issues that have been identified in the *AO* for discussion and other issues that have emerged from consultation with IMF member countries. Appendix I includes proposals for the future work, while Appendix II includes a brief compilation of main issues for possible review in the *Guidelines.* Appendix III is the section on reserve assets included in the *AO*. The issues on international reserves in this document are consistent with official reserve assets as presented in Section I.A. of the Data Template.

II. Methodological Issues

A. Clarification of Definition

5. The **definition of reserve assets** is given in *BPM5* and the *Guidelines* as, “external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating magnitudes of such imbalances through intervention in exchange market to affect the currency exchange rate, and/or for other purposes”(*BPM5*, paragraph 424; and *Guidelines*, paragraph 64). Although this definition remains valid, there may be some aspects of the definition that may need to be reviewed.

6. It is now proposed to consider whether the concepts of **“effective control”,** and **“availability for use”** can be given much clearer and tighter operational meaning in order to reduce the ambiguity in the definition and, consequently, which financial assets comprise reserves (*AO* 5.59). In addition, the ability to use these assets to raise external liquidity in the event of a crisis or at times of market stress should be a key consideration in the discussion. Thus, the inclusion of more objective criteria for issues such as **readily available** are needed.

7. Considering the function of reserve assets, as mentioned before, the above definition and eligibility included in paragraph 424 of *BPM5* remain valid. Although paragraph *AO* 5.46 mentions that to avoid vagueness in reserve assets’ definition, the last phrase “and/or for other purpose” should be removed**,** it is important to analyze in detail the possible explanations of the phrase given in paragraph 425 of *BPM5,* such as **maintaining confidence in the currency**, and evaluate whether the phrase could be deleted or not.

8. Also, as stated in the *BPM5* (paragraph. 426), reserve assets always refer to **assets that actually exist**. Credit lines, guarantees, and central bank swap arrangements are not recognized as actual assets and, therefore, are not reserve assets. Foreign currency assets obtained from the activation of these schemes can be considered reserve assets based on their own characteristics. Further discussion on this concept to improve clarity may be needed.

B. Monetary Authorities, Scope of Reserve Holding Institutions

9. In many countries, not only the central bank but also in parts of the central government or commercial banks, there are usable foreign currency assets that are readily available to meet balance of payments needs. Further discussions on the scope of reserve holding institutions (e.g., state banks) different from the central bank that engage in transactions usually reserved for the monetary authorities may be needed.

10. Although it is proposed in the *AO* that the new *Manual* no longer use **“monetary authorities”** as an institutional sector, monetary authorities should remain a “functional concept” encompassing the central bank (and other institutional unit such as currency board, monetary agency, etc.) and certain operations usually attributed to the central bank but sometimes carried by other governmental institutions or commercial banks (*AO* 5.52, *BPM5* paragraph 514, the *Guidelines* paragraph 21).

C. Characteristics of Instruments Classified as Reserve Assets (*AO* 5.46, 5.59)

Definition

11. The *Guidelines* provides a useful explanation in paragraphs 65, 67, and 68 of the criteria such as usability for assets to be classified as reserve assets.

Available for use

12. "Reserve assets are, first and foremost, liquid and marketable assets readily available to the monetary authorities" (*Guidelines*, paragraph 65). *AO* 5.56 lists a comprehensive set of principles that could provide an interpretation of the concept of the **"available for use,"** these include conditionality, foreign currency, liquidity, and quality of assets.

Conditionality

13. **Owned assets** that are immediately available can be viewed as assets in the most unconditional form (paragraph 431 of *BPM5*) and so included in reserve assets, provided they meet the other criteria.

14. Monetary authorities sometimes arrange the lending of assets to third parties which will not be available to the creditor until maturity of the lending, and prior to maturity are not marketable. These **assets are not readily available** (paragraph 72 of the *Guidelines*) and so not to be included in reserve assets.

15. The *Guidelines* provides a clear view on the treatment of **pledged assets**: "Assets pledged are typically not readily available. If clearly not readily available, pledged assets should be excluded from reserves" (paragraph 72). *BPM5* states in paragraph 426 that "… assets that are pledged, committed, earmarked, set aside in sinking funds, sold forward, or otherwise encumbered by the holders are nonetheless existing and are not precluded on those grounds alone from being included in reserve assets…." The same paragraph goes on to suggest that supplementary information concerning the arrangements would be useful. It is proposed that the new *Manual* will adopt the *Guidelines*' text.

16. Judging from the definition of reserve assets, the principle shown in paragraph 72 of the *Guidelines* could apply to other arrangements, including **encumbrance and ring fencing**, that limit usability of foreign currency assets held by monetary authorities. Also, in the light of country experience, any requests for further clarifications on the treatment of pledged assets and collateral guarantees as discussed in the Data Template could be considered.

Foreign currency

17. Only **foreign currency assets** are eligible as reserve assets, in line with the *Guidelines* (*AO* 5.56 (a), the *Guidelines* paragraph 66). Nonconvertible foreign currency assets will not be included (*AO* 5.56 (b), *Guidelines* paragraph 67). Issues such as the

inclusion in reserve assets of monetary authorities' holding of non convertible currencies of neighboring countries used for trade could be discussed.

18. **Currency of denomination** and that of settlement are different in some financial instruments. *BPM5* and the *Guidelines* do not provide clear views on the treatment of such assets and various possibilities could be investigated. In particular, it is proposed that the **following treatments could be explored for assets** that meet the other criteria of reserve assets:

(a) Assets denominated in foreign currency but settled in domestic currency by the issuer

- If the monetary authorities cannot obtain convertible foreign currency with this kind of asset, the asset should not be classified as reserve assets. But if convertible foreign currency could be obtained from the sale of these instruments, then it could be argued that these assets are reserve assets.

(b) Assets denominated in domestic currency but settled in foreign currency by the issuer

- These instruments could be excluded from reserve assets because foreign currency is not obtainable to the authorities, except at maturity.

(c) Assets denominated in a foreign currency but settled in a different foreign currency.

- These instruments could be classified as reserve assets provided both currencies are convertible.

Liquidity and quality of assets

19. As suggested in *AO* 5.56(c) marketability is component of liquidity. Wording to state the kind of market for an asset is relevant. Questions such as "Is an established secondary market sufficient?" or "Could the availability of a potential market qualify be sufficient ?" could be considered.

20. Similarly, *AO* 5.56(g) mentions the assets' ability to repo is not sufficient to make it liquid─rather liquidity should be based solely on the liquidity of the instrument itself.

21. The quality of assets held as reserve assets are not fully elaborated in *BPM5*. The *Guidelines* (paragraph 89) mention that reserve assets will be required to be of sufficient **high quality** (investment grade and above). This text can be introduced into the new *Manual*.

D. Treatment of Specific Instruments/Transactions

Investment funds (no reference in AO)

22. **New investment schemes** have emerged since 1993. Among others, issues on investment funds and pooling assets within the context of international reserves could be elaborated further.

23. The continued accumulation of international reserves in some countries has renewed interest in the **creation of investment funds** in their different modalities, similar to those created by oil producing countries in last decades. The objective oriented to "return" rather than "liquidity for balance of payments needs."

24. The key issues to determine if the external assets of investment funds can be considered as reserve assets are: (i) do they meet the criteria of liquidity (paragraphs 65 and 67 of the G*uidelines*), (ii) are they foreign currency claims on non-residents (paragraphs 66 and 69), and (iii) are they under the effective control of and readily available to the monetary authorities to meet a balance of payments need (paragraph 65). Also, see *BPM5* paragraph 428.

25. In this context, it is **important to know on whose books these assets are held.** This is because if the external assets are on the books of the central bank, and the central bank or the Ministry of Finance (MOF) is able to control the investment strategy, which so allows control over the disposition of funds, then the *presumption* is that they are international reserves. However, it is still possible that these assets are on the books of the central bank and they are not readily available to meet a balance of payments need─such as if there are legislative restrictions on the use of the assets. On the other hand, if the funds are held in a long-term fund separately incorporated, the presumption is that they should not be included in reserves, not least because the readily availability criterion is less likely to be met.

Pooling assets (AO 5.55)

26. Pooling arrangements are **collective investment schemes** under which funds collected from participants are held in an investment vehicle that conduct re-investments, usually with direct instructions from fund managers[1].

27. Such schemes raise issues not only on **availability for use** and **the effective control** of the monetary authorities over the assets but also cases in which (i) the funds may be re-invested in residents liabilities, and where (ii) the fund's assets might be re-invested in assets

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[1] Recent examples of pooling arrangements include Asian Bond Fund (ABF) and Asian Bond Fund 2 (ABF2) agreed by the EMEAP (Executives' Meeting of East-Asia and Pacific Central Banks) member central banks and monetary authorities. See EMEAP's press releases http://www.emeap.org/press/02june03.htm and http://www.emeap.org/press/16dec04.htm.

denominated in a country's own currency. Thus, the use of these assets to generate external liquidity may be constrained. Issues such as the possibility to implement benchmarks for collective investment schemes on both the level of claims on residents and in domestic currency above which investments in such schemes might not, for any individual country, be classified as reserve assets could be discussed.

28. First, in order to assess the availability for use of these assets, it is proposed that whether the assets in such pooling arrangements can be regarded as reserves assets, or not, should be decided based on close examination of the **legal and institutional arrangements** for each case, rather decided *a priori*. The ability to use these assets to raise external liquidity in the event of a crisis should be a key consideration for discussion.

29. Also, transparency for this type of arrangements is important, particularly in the Data Template. Examples include: (i) the amount of investment in pooled assets, and (ii) the amount of re-investment of these pooled assets in the country's own liabilities.

30. Regarding **control of pooled assets**, it will be important to discuss in which circumstances the investment strategy is defined and the possibility of assets being invested in domestic markets via an alternative investment vehicle. For instance, circumstances whereby a monetary authority invests reserves in domestic assets via an offshore vehicle could be explored.

Treatment of bank deposits in resident banks

31. *BPM5* states that the reserve assets consist of "external assets" (paragraph 424). Also, the *Guidelines* state more explicitly "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 included in reserve assets" (paragraph 69).

32. Nonetheless, *BPM5* and the *Guidelines* agree to include **monetary authorities' foreign currency deposits in resident banks** as reserve assets, provided such deposits are under the direct and effective control of the monetary authorities (paragraph 429 (*BPM5*) and paragraph 68 (*Guidelines*)). The logic is that the claim on the resident bank can be regarded as a proxy for a counterpart claim held by the resident bank with a nonresident. However, recording practices differ from country to country (see the first half of paragraph 108 of the *Guidelines*)[2].

33. **Tightening up the existing *BPM5* exceptions** may be warranted in the current circumstances. This aspect could be constructed on the criteria of effective control as mentioned in *AO*5.54(a), "Effective control must be evidenced by prior contractual

[2] To avoid the double counting, the methodology requires that in the overall IIP/BOP the counterpart claims will be deducted from the data for the banking sector.

arrangements that give the monetary authorities access on demand to the assets in question. The contractual arrangements must be actual and definite in intent."

34. Further, in terms of availability of use, the eligibility as international reserves of external claims on foreign branches and subsidiaries of banks headquartered in the reporting country and/or their separate identification, as provided in the Data Template could be discussed.

Treatment of reverse transactions (*AO* 5.51 (c))

35. The *AO* 5.51 (c) suggests excluding gold and securities that have been transferred under gold swaps, repurchase agreements, securities lending, or as collateral from reserve assets, so eliminating the alternative treatment (paragraphs 85 (iii) and 101).

36. Paragraph 85 (i) of the *Guidelines* suggests that "In reporting **repos and related activities**, it is important to avoid double-counting both the funds received and the securities repoed among reserve assets..." although the *Guidelines* then provides an alternative solution (paragraph 85(iii)). Deleting this alternative solution and leaving the solution in paragraph 85(i) as the single approach to adopt for repos and related activities, could be discussed.

37. The arguments for changing the guidance are:

- Avoid overstatements of reserve assets that come from including both securities/gold under reverse transactions and funds received into reserve assets, (*Guidelines* paragraph 85 (iii)).

- The uniform treatment on reverse transactions could improve international comparability of reserve data (*Guidelines,* paragraphs 85-88).

38. The treatment in the reserves data of reverse repos, funds acquired under repo, and cash collateral provided in securities lending should be made explicit both in the new *Manual* and in the *Guidelines*. Reverse repos can have a significant impact on the reporting of international reserves according to the accounting preferences.

Definition and eligibility of monetary gold (*AO* 5.48, 5.51(a))

39. *BPM5* states that, "**Monetary gold** is gold owned by the authorities (or by others who are subject to the effective control of the authorities) and held as a reserve asset" (paragraph 438). See also the *Guidelines,* paragraph 98. No objective guideline on what gold should be recorded under monetary gold is given except for purity [3]and it looks as if it depends on each

[3] BPM5 states that, "monetary gold is generally construed to be at least 995/1000 pure" (footnote 10, paragraph 438).

authorities' intention. As a result, the borderline between monetary gold and other gold is ambiguous and may require clarification.

40. Some central banks have questioned the guidance in the *Guidelines* under which gold deposits are recorded under gold rather than as deposits (paragraph 99). Should this issue be reconsidered?

41. The *Guidelines* makes no reference to gold deposits in institutions other than bullion banks. Such arrangements occur and so need to be advised. In advice provided, STA staff have stressed the importance of the asset quality of the counterparty.

Financial derivatives (*AO* 5.48)

42. When the IMF recommended the introduction of the new category, "financial derivatives", with *Financial Derivatives: A Supplement to the Fifth Edition (1993) of the Balance of Payments Manual (2000) (FDS-BPM5)*, all **financial derivatives** in various functional categories except for those in direct investment[4] and reserve assets were transferred from previous functional categories to the new category, "financial derivatives."

43. It was proposed in the *Guidelines* that other reserve assets (Section I.A.(5)) include assets that are liquid and readily available, but not included in other categories of reserves. An example is financial derivatives (paragraph 102 of the *Guidelines*); but only those financial derivatives that pertain to the management of reserve assets are to be included. The wording of the *Guidelines* could be considered for inclusion in the new *Manual,* and perhaps reviewed for clarity, or financial derivatives currently included in reserve assets could be removed and included in the functional category, financial derivatives.

Central banks swaps arrangements (*AO* 5.51)

44. There are no changes suggested. *AO*5.51(d) mentions that "Assets created under swap agreements (between monetary authorities) will be treated as in *BPM5*, paragraph 434."

Equity (*AO* 5.51)

45. In addition, *AO*5.51(e) suggests that equity assets can potentially be included in reserves if they meet all the requirements of a reserve asset, as in the *Guidelines* (paragraph 79).

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[4] Later, the IMF proposed the Committee to remove financial derivatives in the direct investment category and record them under the functional category "financial derivatives" ("*Classification of Financial Derivatives in Direct Investment Statistics*", presented at the 2001 Committee meeting). Given the acceptance of the Committee, the IMF determined and released the change ("*Classification of Financial Derivatives Involving Affiliated Enterprises in the Balance of Payments Statistics and the International Investment Position (IIP) Statement*", June 2002).

“Other claims” (*AO* 5.48)

BPM5 states that, “Other claims is a residual category covering claims that are not included previously and that may constitute *reserve assets* in the form of currency, deposits, or securities” (paragraph 443). Also, the G*uidelines* states that “Only the extent that **working balances** abroad of government nonmonetary agencies or assets that are held by banks and subject to the control of the monetary authorities are recorded under “other claims” in *BPM5*” (footnote of Table 2.1 of the *Guidelines,* page 21). The *AO* proposes that “other claims” be included as a component of foreign exchange rather than shown as a separate component of reserves. Additional discussion on such items not to be covered as other claims, such as capital contributions to international organizations, may be useful. Working balances are part of the discussion of the *AO* under paragraph 5.54(b).

E. Treatment of Reserve Related Liabilities (*AO* 5.60 – 5.62)

Reserve liabilities of monetary authorities

46. Data on **reserve liabilities** of the monetary authorities are among those required for Fund surveillance. Outside analysts have also expressed interest in such data. The relevance for introducing reserve related liabilities into the new *Manual* could be discussed, especially from the viewpoint of avoiding misleading messages when the net reserve assets are considerably smaller than the gross data, or even negative.

47. A net international reserves (NIR) concept would subtract reserve related liabilities from gross international reserves (GIR). In discussing this concept, some issues elaborated in the *Balance of Payments Textbook* (paragraphs 625-640) could be drawn upon. Also the Data Template provides a framework, Section II (Predetermined short-term net drains on foreign currency), to present information on the foreign currency liabilities of monetary authorities and central government. While such liabilities could include claims on residents, and Section III provides liquidity not stock information, the experience with the Data Template could be drawn upon in defining reserve related liabilities.

Liability aspects of SDRs

48. **SDRs** have some liability-like aspects: interest can be incurred on SDRs and a country is required to repay its allocation of SDRs when the country leaves the membership of the Fund. Also, arrears on SDRs related payments are liabilities.

49. Paragraph 440 of the *BPM5* states that, “SDRs are not considered liabilities of the Fund, and IMF members to whom SDRs are allocated do not incur actual (unconditional) liabilities to repay SDR allocations”. Should this be reviewed, and if so, how could such liabilities be incorporated into the framework?

Liabilities constituting foreign authorities' reserves (LCFAR, *AO* 5.60)

50. The classification for LCFAR should be discontinued since it has not been implemented.

Reserve assets in currency unions

51. Issues such as the definition of reserve assets in the context of a Currency Union (CU) could be elaborated. These issues are being discussed by the Currency Union Technical Experts Group (CUTEG)[5].

[5] See "*Definition and Allocation of Reserve Assets in a Currency Union (CUTEG Issues Paper #10)* and its outcome paper. Both documents are available on the IMF's website (http://www-stg-ext.imf.org/external/np/sta/bop/cuteg.htm).

Proposed Future Work

1. Given the technical nature of the issues that may need to be considered, it is proposed that a reserve assets technical expert group, to be named RESTEG, be established to assist the discussion and solution of detailed issues on reserve assets. A proposed schedule is included below. We welcome views of the IMF Committee on Balance of Payments Statistics (BOPCOM).

2. The scope of the Data Template, which includes not only reserve assets but international liquidity concepts, is wider than reserve assets in *BPM5*. However, the *Guidelines* will need to be amended to be consistent with the new *Manual*. Given this, it is proposed that the RESTEG could continue after it has completed its work on reserve assets, to discuss the revision of the *Guidelines,* although the composition of members could be reassessed. We propose that if the RESTEG is created, BOPCOM decide at its annual 2006 meeting whether to extend RESTEG's work into the issues affecting the revision of the *Guidelines.*

Preliminary Timetable for Reviewing Reserve Issues and Updating the Guidelines

Date	IMF	Committee	RESTEG
June 2005		IMF Committee meeting. Agree issues to address and establishment of the Reserve Assets TEG (RESTEG).	
July–September 2005	Select and invite RESTEG members.		
December 2005			Papers due for the first RESTEG meeting.
February 2006			The first meeting of RESTEG.
May 2006			Papers due for the second RESTEG meeting.
June 2006			The second meeting of RESTEG.
July–September 2006			Prepare recommendations to the Committee
October 2006		Committee meeting. Discuss recommendations from RESTEG and expect to reach agreement. Agree on next phase of RESTEG work on Sections I.B., II–IV of the Data Template.	
November 2006–March 2007	Draft the paragraphs on reserve assets. The draft is to be included in the draft of other chapters of the next *BPM* and released on the IMF's website.		
May 2007			Papers due for the third RESTEG meeting on the issues relating to Sections II–IV.

Date	IMF	Committee	RESTEG
June 2007			The third meeting of RESTEG.
July 2007–September 2007			Prepare recommendations to the Committee.
October 2007		Annual meeting. Discuss recommendations from RESTEG; and expect to reach agreements.	
November 2007–June 2008	Draft the update of reserves template guidelines and send to IMF member countries and international agencies for comments (due September 2008).		
October 2008		Committee meeting Discuss comments on the draft guidelines; and expected to reach agreements on outstanding issues	
December 2008	Final draft, subject only to editing, posted on the IMF's website.		
Beginning in January 2009	Prepare hardcopy publication, index, translations.		

Issues for Possible Review on the *Guidelines*, Other than Section I.A.

In addition to the revision of Section I.A. Official Reserve Assets, some other sections of the *Guidelines* should be reviewed before the new *Manual* is finalized.

This attachment presents issues that could be discussed. They are drawn from the feedback and questions STA has received on the Data Template.

1. Section 1

(1) It should be elaborated in the *Guidelines* that foreign currency claims on the monetary authorities and central government should be excluded from Section I. B., for example central bank purchases of central government Eurobonds. This should be elaborated in the *Guidelines*. The treatment of claims on other parts of the public sector should be clarified.

(2) The concept of working balances abroad of government agencies in Section I.B. (paragraph 125), and their impact on reserve assets and other foreign currency assets needs to be clarified.

2. Section II and III

(1) It should be clarified what predetermined means (future receipts from sale of commodities, scheduled disbursements of loans, arrears, claims in disputes, claims on liquidating units, etc.). In particular, the future disbursement of funds are excluded—paragraphs 140 and 166 of the *Guidelines* have been misinterpreted and led to a number of countries to include the future disbursement of funds in Section II.

(2) Timing, valuation, and conversion issues should be clarified. Drains should be recorded, not on an accrual basis, but on a due for payments basis. The recording in circumstances where it is known with certainty that the payments (inflows or outflows) will take place, but no asset or liability is yet recorded in the books of the creditor/debtor, should be clarified, e.g. disbursement of loans.

(3) The distinction be drawn between predetermined and contingent (sections II and III) could be classified—for example for deposits held under reserve requirements.

(4) The accounting for guarantees, collateral (and non-collateral) could be clarified, (paragraphs 193-195 of the *Guidelines*).

(5) A description of the relationship between reserve liabilities and Section II (predetermined net drains) and III (contingent net drains) could be considered.

3. Section IV

(1) The relationship between reporting of derivatives in Sections I, II, III, and IV could be elaborated as the relationship among sections can be used as a cross-check.

(2) The recommended treatment in 85 (ii) of the *Guidelines* for reverse repo and a repo asset results in recording one transaction in both “I.B. Other Foreign Currency Assets” and “IV. (1). (d) (securities) borrowed or acquired but not included in Section I.” when the relevant securities are liquid and available upon demand to the authorities. This description is not contradictory but could be further clarified.

(3) Should gold swaps be separately identified as a footnote to Section IV (1)? The *Guidelines* mentions the recording of gold swaps in the Data Template in paragraphs 98, 100-101, 178, 258, however detailed information on swapped gold is not required.

(4) Should country risk be addressed through encouraging the provision of more detailed information on reserve composition through country notes?

4. Other issues

(1) Currency unions

- Definition and allocation of reserve assets in a currency union is discussed in CUTEG (issues paper #10). Should reserve related issues on currency unions be elaborated in the *Guidelines*?

(2) Dollarization

- Should the *Guidelines* discuss recording issues for countries for which the dollar (or another foreign currency) is legal tender. Should dollarized economies be treated differently from others? Should reserve related issues in dollarized economies be separately elaborated?

- How should dollar denominated assets be treated in Section I., and foreign currency drains in Section II and III in dollarized economies?

(3) Alternative treatments

- For a number of issues, the reserves template accepts plural treatments and requires descriptions on specific treatments in country notes. This may impair comparability of the data. In addition, since country notes are often insufficient or not provided, the transparency of the data could be impaired.

(4) Introduction of "dual template"

- If data of monetary authorities and central governments are reported separately, such issues as the consolidation vs. aggregation of drains, and positions between monetary authorities and central government could be addressed.

Section on Reserve Assets Included in the Annotated Outline
(Sections 5.46–5.62)

5. Reserve assets

5.46 The definition of reserve assets will be stated, along the lines of paragraph 424 in *BPM5* and paragraphs 9 and 64 of the *Reserves Template*, but it is proposed that the definition remove "and/or for other purposes" in paragraphs 424 of *BPM5* as it is too vague.

> *[Questions: (i) Is this change acceptable? (ii) If so, does there need to be a definition of "for balance of payments purposes"?]*

5.47 It will be explained that these assets must be under the effective control of the monetary authorities and be available for use should the need arise. The concepts of "effective control" and "availability for use" will be discussed (see below). This section will also refer to the Fund's *Guidelines for Foreign Exchange Reserve Management* (*GFERM*) (2001) and explain the relationship between it and the manual. This section will also refer to the supporting document on the Fund's external website Foreign Exchange Reserve Management: Operational and Technical Issues (2002) (GFERM Documentation). The introductory section will explain the treatment of reserves in the *Reserves Template* and in the *GFERM* (neither of which existed when *BPM5* was drafted).

5.48 This section will state that reserve assets include monetary gold, SDRs, reserve position in the Fund, and foreign exchange, with a further breakdown by instrument (currency and deposits, securities, and other claims). It is proposed that, unlike *BPM5,* as modified in *Financial Derivatives Supplement to the Fifth Edition of the Balance of Payments Manual* (2000), financial derivatives not be included in reserves and that "other claims" be included as a component of foreign exchange rather than shown as a separate component of reserves.

> *[Question: Are the proposed treatments of financial derivatives and other claims acceptable?]*

5.49 It will be noted that SDRs and gold have no counterpart liability.

5.50 The counterpart liability for other reserve assets will be stated as being obligations of nonresidents, that is, obligations of residents will not qualify, as explained in the *Reserves Template* paragraphs 62 and 69.

5.51 The particular instruments that may or may not be included in reserves will be discussed in more detail, as they are more limited in ways that do not arise for other functional categories:

(a) Gold deposits (also called gold on loan in the *Reserves Template*) will be included under gold (*Reserves Template* paragraph 99). This item will be limited to monetary gold.

(b) Silver bullion, diamonds, and other precious metal and stones will not be included (*Reserves Template* paragraph 98). These are outside the scope of IIP.

(c) Gold and securities that have been transferred under gold swaps between monetary authorities, repurchase agreements, securities lending, or as collateral will not be included as reserve assets. (This would represent a change from some treatments in *Reserves Template* paragraph 82-88 and paragraph 101 but avoid double counting of the security and the funds raised through repurchase agreements.)

(d) Assets created under swap agreements will be treated as in *BPM5* paragraph 434.

(e) Equity can potentially be included in reserves if it meets all the requirements of the definition, as in *Reserves Template* paragraph 79.

(f) Lines of credit will not be included as they are not assets, as in *Reserves Template* paragraph 73.

[Questions: (i) Is the change to exclude assets under repurchase agreements acceptable? (ii) Are any other changes necessary?]

5.52 Although it is proposed that this manual no longer use "monetary authorities" as an institutional sector (see Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence), "monetary authorities" will be defined as a functional concept that is essential for holding "reserve assets." Monetary authorities comprise the central bank and certain operations usually attributed to the central bank (and other institutional units, such as currency boards and monetary authorities) but sometimes carried out by other government institutions or commercial banks (*Reserves Template* paragraph 21).

5.53 This section will explain that the concepts of "effective control" and "usability," as stated in the *Reserves Template* paragraph 65, underpin the concept of "availability."

5.54 "Effective control" will be applied to determine whether the monetary authorities have control over the liquid foreign currency claims on nonresidents of entities that do *not* comprise part of the monetary authorities. This section will state that, to comprise part of "reserve assets," the liquid foreign currency claims on nonresidents owned by other government or public sector bodies or other depository corporations must meet a test of effective control. Specific guidelines for interpreting effective control over the foreign assets of entities that do not comprise part of the monetary authorities will be provided. This section will also address the question of how the potential double counting of the assets is to be addressed. Other relevant considerations are as follows:

(a) Effective control must be evidenced by prior contractual arrangements that give the monetary authorities access on demand to the assets in question. The contractual arrangements must be actual and definite in intent.

(b) Working balances will need to be considered on the basis of effective control, rather than included by convention, as in *BPM5* paragraphs 433 and 443.

[Questions: (i) Are there any other issues concerning control to be dealt with? (ii) Should assets owned by other agencies but under the effective control of the monetary authorities be shown as a separate component of reserves and/or should those assets be not recorded as the assets of the owner to avoid double counting?]

5.55 *BPM5* is not explicit on the inclusion of pooled assets in reserve assets. It will be noted that pooling arrangements and investment in securities that are used to hold other securities raise the possibility of the part of the ultimate liability being owed by residents, and hence the potential to generate international liquidity is undermined.

[Question: Should pooled assets be able to be included as reserve assets?]

5.56 The term "available for use" is synonymous with "liquidity," which in turn implies "marketability" for some instruments (e.g., securities). Liquid foreign currency claims on nonresidents owned by the monetary authorities will comprise part of "reserve assets." Principles will be stated that provide an interpretation of the concept of "available for use," viz.:

(a) only foreign currency assets will be included (*Reserves Template* paragraph 66);

(b) nonconvertible foreign currency assets will not be included (*Reserves Template* paragraph 67);

(c) the kind of market for the instrument must be stated (for example, an established secondary market is a sufficient condition; the availability of a potential market could qualify, but the funds will be required to be unambiguously available if the asset is to be included in reserves);

(d) foreign currency assets must be available on demand (for example, deposits (see *Reserves Template* paragraph 91), and gold loans (see *Reserves Template* paragraph 99). Or they must be marketable with minimum cost and time and with ready sellers and buyers, for example, securities (*Reserves Template* paragraph 65, footnote 19);

(e) pledged assets that are encumbered by a nonresident party (such as collateral for a third party loan) will be excluded, as stated in *Reserves Template* paragraph 72. Pledged assets that are encumbered by the monetary authorities for prudential purposes (such as a sinking fund) will be included, as stated in *BPM5* paragraph 426;

(f) reserve assets will be required to “be of a sufficiently high quality (investment grade and above)” to qualify as being sufficiently readily available, as in *Reserves Template* paragraph89;

(g) the asset’s ability to be involved in a repurchase agreement sufficiently enough to make it liquid will be stated. (It is proposed that it not be sufficient for the asset’s inclusion or otherwise should be based solely on the liquidity of the instrument itself); and

(h) a noncomprehensive list of examples will be given of instruments that are definitely considered as sufficiently liquid (e.g., gold, SDRs, reserve positions in the Fund, foreign exchange holdings) and those that are definitely not considered to be sufficiently liquid (e.g., long-term loans, real estate). (The examples are from *BPM5* paragraphs 431–432 and *Reserves Template* paragraph 74–76.)

5.57 An appendix will cover the particular issues associated with reserve assets of monetary and currency unions and reserve assets held by a national central bank that is a member of a monetary union.

5.58 This section will note that, in presenting reserves data by institutional sector, compilers may wish to adopt a supplementary institutional sector “monetary authorities,” as noted in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence.

5.59 *BPM5* states (paragraph 426) that the financial assets comprising reserves cannot unambiguously be identified in a meaningful way simply through the application of objective criteria. It is now proposed to give the concepts of ownership, control, and usability much clearer and tighter operational meaning, in order to reduce the ambiguity in determining which financial assets comprise reserves.

[Questions: (i) Is it possible to develop objective criteria for the identification of reserves? (ii) If so, what are those criteria?]

5.60 It will be noted that this functional category occurs only on the asset side. *BPM5* encouraged Liabilities Constituting Foreign Authorities’ Reserves (LCFAR) as a supplementary classification. The classification for LCFAR will be discontinued since it is considered to be impractical and has not been implemented.

5.61 It will also be noted that borrowings that may have been undertaken to bolster reserve assets are not to be shown as negative entries in reserve assets.

5.62 This section will note that reserve assets give an incomplete picture of the authorities’ international liquidity position, for example by omitting related liabilities. The Reserves Template provides a satellite presentation, that is, it is based on the core concepts of the international accounts but provides considerable extra detail on components of reserve assets, as well as other kinds of assets, associated liabilities, and other foreign currency drains and seeks information on future flows. It is envisaged that the Reserves Template will be updated in line with the revised manual.