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

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**LIABILITY ASPECTS OF SDRs**

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## **Liability Aspects of SDRs**

SNA Update Issue

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### **Executive Summary**

In the *1993 SNA* and *BPM5*, the SDR is classified as an asset without a corresponding liability because there is no actual (unconditional) liability to pay their SDRs allocations.

Some recent developments including the possibility that a country might leave the IMF membership have led the IMF to look again at the issue of the liability attributes of the SDR. Also, the *Monetary and Financial Statistics Manual (MFSM)* recommends that the value of allocated SDRs is shown both on the assets and liabilities side on the balance sheets of central banks, similar to the IMF's SDR Department's guidance to member countries.

This paper argues that the SDR holdings and allocation should be regarded as gross assets and liabilities in the system. SDR holdings clearly meet the definition of an asset in that ownership rights can be enforced, economic benefits are derived by the owners by holding them or using them over a period of time, and they are stores of value (*1993 SNA* paragraph 11.16). SDR allocations have attributes of a liability as countries are required to pay interest on them and if a country left the membership of the Fund it would be required to repay its obligations including any allocation of SDRs. This paper also argues that given the recognition as a liability, transactions should be recorded at the time of the allocation of SDRs, that is, when economic value is created.

This paper asks the Advisory Expert Group (AEG) if the following proposals are acceptable:

- *Should countries recognize SDR allocations as gross liabilities in the system?*
- *Should the allocation and cancellations of SDRs be classified as transactions?*

## I. INTRODUCTION

1. It is stated in paragraph 11.67 of the *System of National Accounts 1993 (1993 SNA)* that "IMF members ... do not have an actual (unconditional) liability to repay their Special Drawing Rights (SDR) allocations." The fifth edition of the *Balance of Payments Manual (BPM5)* makes a similar statement, (paragraph 440).
2. Some recent developments have led the IMF to look again at this issue. First, the possibility that a country might leave the IMF membership has raised the issue of the repayment of the SDR allocation. Second, some members have long-standing arrears on their SDR account. Third, some outside analysts have begun to question the present *SNA/BPM5* treatment.<sup>1</sup>

## II. CURRENT INTERNATIONAL GUIDANCE

3. The methodology of the *1993 SNA* and *BPM5* recommends that member countries of the IMF classify the SDR allocation as an asset, but not as a liability because there is no actual (unconditional) liability to repay their SDR allocation.
4. *SNA 1993* states (paragraph 11.67) that "SDRs are international reserves assets created by the IMF and allocated to its members to supplement existing reserve assets. Transactions in SDRs are recorded in the financial accounts of the monetary authorities and the rest of the world, respectively. They are not considered liabilities of the IMF, and the IMF members to whom SDRs are allocated do not have an actual (unconditional) liability to repay their SDRs allocations...SDRs represent each holder's assured and unconditional right to obtain other reserve assets, especially foreign exchange..." Paragraph 11.68 clarifies that "The mechanism by which SDRs are created (referred to as allocations of SDRs) and extinguished (cancellation of SDRs) is not treated as one that gives rise to transactions in *SNA* but rather to entries in the *other changes in volume of assets (OCVA)* account."
5. *BPM5* (paragraph 440) is drafted in accordance with *1993 SNA*, and adds that "Changes in the SDR holdings of monetary authorities can arise through (i) transactions involving SDR payments to or receipts from the IMF, other participants in the SDR Department of the IMF, or other holders or (ii) allocation/cancellation. Transactions such as those enumerated under (i) are included in the balance of payments; allocations or cancellations are not entered in the balance of payments but are reflected in the international investment position."
6. Other methodologies, such as the *Government Finance Statistics Manual 2001 (GFSM)*, (paragraph 7.95), the *Monetary and Financial Statistics Manual (MFSM)*,

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<sup>1</sup> For example, Mr. Richard Erb, a former Deputy Managing Director of the IMF, who wrote an article on this topic in *Central Banking*, (Vol. XIV, No. 3).

(paragraph 121), and the *External Debt Statistics: Guide for Compilers and Users (Debt Guide)*, (page 273) are consistent with these recommendations.

7. However, the *MFSM* in Appendix 1 recommends inclusion of the SDR allocation on the liability side of the balance sheet of central banks. Paragraph 474 states that: “Allocations of SDRs that are provided to member countries by the IMF with no requirement to repay and are recorded in central bank’s balance sheet under the category for *shares and other equity* rather than as foreign liabilities.” The classification as shares and other equity in essence reflects that the allocation is in the nature of an unrequited transfer, and it is recorded as an OCVA. However, it is highly unusual for an interest-bearing financial instrument to be included in equity.

### III. SDR ACCOUNTING IN THE IMF

8. The SDR Department was established to conduct all transactions in SDRs following the creation of the new international reserve asset by the IMF in 1969. The Articles of Agreement of the IMF require that the General<sup>2</sup> and SDR Departments be kept strictly separated, such that assets in one department cannot be used to meet liabilities of the other, except for the reimbursement of the General Department. This separation reflects the fact that the SDR facility is an entirely separated mechanism of the IMF<sup>3</sup>.

9. The IMF should best be considered purely as an administrative agent, no more. The membership (SDR participants) incurs the asset/liability positions unto itself. Thus, the SDR allocation is the liability of a member to the membership, for whom it is an asset. In turn, the membership provides the allocation issuer with SDR assets, which are its liability; it stands ready to redeem them with usable foreign exchange. In short, the SDR Department is a cooperative arrangement among the members and other participants. Participants whose current SDR holdings are *less than* their SDR allocations have a *combined liability* to participants whose current SDR holdings are *greater than* their SDR allocations (and other SDR participants).

10. There are two types of participants of the SDR Department: those that receive allocations (IMF member countries) and those who do not but can still hold SDRs (such as international agencies). When a country receives an SDR allocation, its SDR holdings equal its SDR allocation. Given that the allocation does not change, as soon as it uses some of its SDRs holdings the country’s allocation exceeds holdings (net debtor), or if it acquires additional SDRs holdings, the country’s holdings exceed allocation (net creditor). Other participants can acquire SDR holdings through transactions, e.g. selling foreign exchange for SDR holdings. Net interest payments are made by net debtors to net creditors through the SDR Department. The claims and liabilities are with the SDR Department.

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<sup>2</sup> All assets and property of the Fund are held in the General Resources Account.

<sup>3</sup> *Financial Organization and Operations of the IMF*, Pamphlet Series No 45, Sixth Edition, 2001, IMF.

11. The SDR Department provides guidance on how member countries with allocations should report these claims and liabilities in the monetary authorities' balance sheet. The SDR allocation should be reflected in the balance sheet of a member's central bank, although the member is given a choice between reporting claims on and liabilities to the SDR Department using either a gross or a net approach. Regarding the accounting in the SDR Department, Appendix 1 has an example of a balance sheet of the SDR Department, which is derived from *Financial Organization and Operations of the IMF*, Pamphlet Series No 45, Sixth Edition, 2001, IMF pamphlet.

12. In the case of arrears, assets are brought into balance with liabilities by treating overdue assessments and charges as a claim of the SDR Department. There is an explicit statement that no losses have been incurred in the past and the current expectation is that no losses will be incurred in the future. In fact it is expected that member countries with arrears will clear them sooner or latter.<sup>4</sup> In the most unlikely event of any losses, these would be borne by the SDR holders, as the value of their claims would be reduced.

13. If a country left the membership of the IMF, a negotiation would occur prior to its departure to settle any obligations that arose from its membership, including repaying its SDR allocation. If the country is in a net SDR liability position it would need to pay in convertible currency to settle its position to the SDR Department.

#### IV. REASONS FOR CHANGE

14. The SDR is an unusual instrument, creating difficulty in the determination of its treatment in the accounts.

15. SDR holdings clearly meet the definition of an asset in that ownership rights can be enforced, economic benefits are derived by the owners by holding them or using them over a period of time, and they are stores of value (*1993 SNA* paragraph 11.16). Further, the purpose for creating the SDR was to supplement reserve assets. Thus, the SDR holdings inclusion in reserve assets on a gross basis reflects its economic nature; a participant that receives an allocation can sell the total amount of their holding for foreign exchange or other forms of economic value.

16. SDR holdings can be acquired either through transactions in existing SDR holdings or through an allocation of holdings. In the first instance, when economic value is exchanged, a transaction is recorded in the system, but in the second instance, at present, there is no transaction because it is considered that a corresponding liability is not created. Rather an *other change in volume* is recorded.

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<sup>4</sup> There are some critics who mention that the treatment of arrears by member countries in the SDR Department does not follow entirely the International Accounting Standards (IAS). Nevertheless, there is at present an extensive array of safeguards to protect Fund resources, including elaborated arrangements to deal with arrears.

17. However, SDR allocations do have attributes of a liability: countries are required to pay the SDR interest rate, a market rate of interest, to the SDR department in the IMF on the full amount of the allocation they have received. From an accounting perspective of the SDR Department this is paid on a net basis, but it is in effect calculated on a gross basis, in that if a country sold its entire holdings of SDRs, it would be making gross payments on the allocation it received.<sup>5</sup> If these amounts are not paid, arrears on SDR-related payments arise—in other words the payment (and hence accrual) of interest is an actual liability that must be met. Second, if a country left the membership of the Fund it would be required to repay its obligations including any allocation of SDRs. The need to pay interest and repay the allocation if a member left the IMF seems to be sufficient to create a liability.

18. If so, then there is a strong argument to record the creation of the liability as a transaction at the time of the allocation. Transactions are recorded when economic value is created (*1993 SNA* paragraph 3.94 and *BPM5* paragraph 111) and are considered to have taken place when the creditor and debtor enter the claim and liability, respectively, in their books (*1993 SNA* paragraph 3.97 and *BPM5* paragraph 123). As noted above, the SDR holdings are considered to be a store of economic value, and so their creation should arguably result in a transaction being recorded in the system. Second, the liability is recorded in the books of the participant to the SDR Department when the allocation is made, and not when the participant starts transactions in the holding, and so the liability is created at the same time as the asset. A helpful comparison would be with a central bank reciprocal swap arrangements (*BPM5* paragraph 434). In this instance, the setting up of the swap facility is not a transaction because no economic value is exchanged. But when such a swap of currencies occurs, even if neither party actually uses the currency received, it is recorded as a transaction with corresponding asset and liability positions between the same two counterparts.

19. Similarly transactions should be recorded if a member left the IMF and repaid their SDR allocation. Indeed, if they had no SDR holdings but simply a gross allocation, they would need to pay some economic value, such as foreign exchange. If the repayment of an allocation is not a transaction, there would be no counterpart entry to the payment of foreign exchange. In other words, because under the present approach a liability does not exist, no transactions could be recorded, despite the payment of foreign exchange.

20. In the *1993 SNA* there is already an instrument category *Monetary Gold and SDRs* in which the SDR is included (AF1). Asset and liabilities could be separately identified (although it should be made clear in the *1993 SNA* that there are no liabilities associated with monetary gold). Within the balance of payments, SDR allocations be considered part of a reserve liability category if one is created (at present this is an issue being discussed in the Technical Expert Group on Reserves set up by the IMF Committee on Balance of Payments

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<sup>5</sup> As long as the member remains a participant in the SDR Department, it can have a net debtor position in perpetuity, with no need to repay the position.

Statistics (BOPCOM)), but otherwise SDR allocations could be classified as an *other investment, other liability, monetary authorities* (central bank), *long term*.

21. Regarding whether an SDR allocation is debt or equity, given the need to pay interest it meets the definition of debt (*Debt Guide* paragraph 2.3).

22. However, the classification as shares and other equity in the *MFSM* reflects that the allocation has the nature of an unrequited transfer. Also, in the *MFSM* framework the revaluation of the SDR allocation has no effect on the value of shares and other equity, as the change in the value of the SDR allocation is offset by a contra-entry that is posted to revaluation adjustment. Both entries are within shares and other equity. This would not be the case if the SDR allocation were classified as debt. The *MFSM* approach is long standing. Further, central banks might consider that it is most unlikely that they are to leave Fund membership and so regard the SDR allocation as akin to an equity and other share.

23. Given this special nature, an alternative is to regard for statistical purposes the SDR allocation by convention as an “other instrument,” that is, neither a debt nor equity instrument.

24. Regarding the consensus for change, this issue has been discussed within all the relevant departments in the IMF.<sup>6</sup> As this issue was placed on the AEG agenda very late in the process, at the time of writing this issue has not been discussed by BOPCOM members but their views will be presented at the discussion of this issue at the AEG in January 2006.

## V. RECOMMENDATIONS

25. Member countries of the IMF, *de-facto*, record the liability side of the SDR allocation in the balance sheet of the monetary authorities, and the International Accounting Standards accounting framework explicitly recognizes such treatment.

26. The following proposals are recommended (see also Appendix II for numerical examples):

- Treat SDR allocations as a gross liability in the position data because of the attributes previously mentioned: (1) countries are required to pay interest to the IMF on the full amount of the allocation they have received net of SDR interest they earn on their holdings, and arrears arise if payments are not made, and; (2) a country would be required to repay its allocation of SDRs if it leaves the membership of the IMF.
- Classify allocation and cancellations of SDRs as transactions. An increase in SDR holdings as a result of an allocation should be recorded as a debit entry in the item for total change in SDR holdings and a counterpart credit entry for SDR allocation. A

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<sup>6</sup> This issue is consistent with the view expressed in Mr. Erb, *op cit*.

cancellation should be recorded as a debit item with the counterpart entries dependent upon whether the participant is in a net debtor or creditor position, and the means of payment to settle the position.

- Other transactions in SDR holdings should be treated as transactions, as at present (see paragraphs 4 and 5 above).
- Continue to treat SDR as an instrument in *SNA, Monetary Gold and SDRs (AF1)*, with assets and liabilities separately identified (although it should be made clear in the *SNA* that there are no liabilities associated with monetary gold).
- In the IIP, SDR allocations be considered part of a reserve liability category if one is created (this is at present an issue being discussed in the Technical Expert Group on Reserves), but otherwise SDR allocations be classified as an *other investment, other liability, monetary authorities (central bank), long term*.
- By convention, the SDR allocation be classified as an “other” instrument; that is, neither a debt nor equity instrument.

27. There should be no practical difficulties in collecting data on SDR allocations. There will be no impact on GDP. The change might impact the current account of the balance of payments, but experience suggest that interest on SDRs holding might have been recorded on a net basis by countries in the past.

#### **Questions/Points for Discussion**

- *Should reporting countries recognize SDR allocations as gross liabilities?*
- *Should the allocation and cancellations of SDRs be classified as transactions?*
- *If so, are the other proposals set out in paragraph 26 acceptable?*

#### **References**

*System of National Accounts 1993*, paragraphs 3.94, 3.97, 11.16, 11. 67 and 11.68

*Fifth Edition of the Balance of Payments Manual*, paragraphs 111, 123, and 440

*Government Finance Statistics Manual 2001*, paragraph 7.95

*Monetary and Financial Statistics Manual*, paragraphs 121 and 474

*External Debt Statistics: Guide for Compilers and Users*, paragraph 2.3 and page 273

*Financial Organization and Operations of the IMF*, Pamphlet No 45, Chapter III and Appendix IV



*Articles of Agreement*, Articles XV to XX, IMF

Richard Erb, “SDR: An International Reserve Liability,” *Central Banking*, Vol. XIV, No 3, February 2004.

**Appendix 1**

**Example of the Balance Sheet of the SDR Department**  
(In millions of SDRs)

Assets		Liabilities	
Participants with holdings below allocations:		Participants with holdings below allocations:	
Allocations	12,646	SDR holdings	14,690
less: SDR holdings	<u>3,866</u>	less: allocations	8,787
	8,780	Holdings in excess of allocations	5,903
		Holdings by GRA	2,437
		Holdings by prescribed holders	538
Interest receivable	215	Interest payable	<u>216</u>
Overdue assessments and interest	<u>98</u>		
Total assets	9,094	Total liabilities	9,094

**Appendix II**

**Treatment of Transactions and Positions of SDRs in  
Member's Accounts**

*Period 1: Initial Allocation*

End of period data

Assumptions: Original allocation of SDR 500,000

**Balance of Payments**

Debit		Credit	
<i>Reserve assets:</i>		<i>Financial Account, other investment, other liabilities of monetary authorities, long term:</i>	
SDR holdings	500,000		500,000

**National Accounts transactions**

Debit		Credit	
AF1 Monetary Gold and SDR	500,000	AF1 Monetary Gold and SDR	500,000

**International Investment Position**

Assets		Liabilities	
<i>Reserve assets:</i>		<i>Other Investment, other liabilities, monetary authorities, long-term:</i>	
SDR holdings	500,000	SDR allocation	500,000
Total assets	500,000	Total liabilities	500,000

**Balance Sheet of the Monetary Authorities**

Assets		Liabilities	
<i>Reserve assets:</i>		<i>Foreign liabilities</i>	
SDR holdings	500,000	SDR allocation	500,000
Total assets	500,000	Total liabilities	500,000

**Period 2: Change in SDR holdings due to a sale of SDR assets**

Assumptions: Sale of SDR 100,000

**Balance of Payments: Reserve Assets category**

Credit		Debit	
<i>Reserve assets:</i>			
SDR holdings	100,000	Other assets	100,000
Total credits	100,000	Total debits	100,000

**National Accounts transactions**

Credit		Debit	
AF1 Monetary Gold and SDR	100,000	AF2 Currency and Deposits	100,000
Total credits	100,000	Total debits	100,000

**International Investment Position**

Assets		Liabilities	
<i>Reserve assets:</i>		<i>Other Investment, other liabilities, monetary authorities, long-term:</i>	
Other Assets	100,000	SDR allocation	500,000
SDR holdings	400,000		
Total assets	500,000	Total liabilities	500,000

**Balance Sheet of the Monetary Authorities**

Assets		Liabilities	
<i>Reserve assets:</i>		<i>Foreign liabilities</i>	
Other Assets	100,000	SDR allocation	500,000
SDR holdings	400,000		
Total assets	500,000	Total liabilities	500,000

**Period 3: Separation from the IMF**

Assumptions: Separation from the IMF and repayment to the SDR Department of the original allocation of SDR 500,000

**Balance of Payments**

Credit		Debit	
<i>Reserve assets:</i>		<i>Financial Account, other investment,</i>	
Other Assets	100,000	<i>other liabilities of monetary</i>	
SDR holdings	400,000	<i>authorities, long-term:</i>	
Total credits	500,000	Repayment of original allocation	500,000
		Total debits	500,000

**National Accounts transactions**

Credit		Debit	
AF1 Monetary Gold and SDR	400,000	AF1 Monetary Gold and SDR	500,000
AF2 Currency and deposits	100,000		
Total credits	500,000	Total debits	500,000

**International Investment Position**

Assets		Liabilities	
<i>Reserve assets:</i>		<i>Other Investment, other liabilities,</i>	
Other Assets	0	<i>monetary authorities, long term:</i>	
SDR holdings	0	SDR allocation	0
Total assets	0	Total liabilities	0

**Balance Sheet of the Monetary Authorities**

Assets		Liabilities	
<i>Reserve assets:</i>		<i>Foreign liabilities</i>	
Other Assets	0	SDR allocation	0
SDR holdings	0		
Total assets	0	Total liabilities	0