

**IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS**

**CURRENCY UNIONS TECHNICAL EXPERT GROUP (CUTEG)**

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**ISSUES PAPER (CUTEG) # 15**

**TREATMENT OF OTHER INTRA-CURRENCY UNION CLAIMS AND LIABILITIES,  
INCLUDING CURRENCY UNION SETTLEMENT AND CLEARING ARRANGEMENTS**

The views expressed in this Paper are those of the author and do not necessarily represent those of the European Central Bank.

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## CURRENCY UNION TECHNICAL EXPERT GROUP

### ISSUES PAPER (CUTEG) # 15

#### **Treatment of other intra-currency union claims and liabilities, including currency union settlement and clearing arrangements**

1. This paper analyses the treatment of several transactions and positions between different members of a Currency Union (CU) and, in some instances, also involving countries pertaining to the Economic Union (EU) which are not members of the CU. Most of the issues analysed in this note correspond to arrangements between central banks, namely the national central banks of the countries participating in the CU (CU NCBs) and the Currency Union Central Bank (CUCB). They are mostly linked to the specific mechanisms necessary for the functioning of a CU such as the holding of pooled reserve assets, the issuance of a single currency or the participation in the CUCB's capital.

2. The complete list of transactions analysed in this paper is as follows:

1. Settlement and clearing mechanisms	2
2. Participation of EU/CU NCBs in the capital of the CUCB	4
3. Claims/liabilities resulting from the initial transfer of reserve assets from CU NCBs to the CUCB	5
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3. It is important to ensure that a consistent treatment is applied to these transactions so as to permit proper consolidation at the CU-aggregate level (for transactions vis-à-vis third parties) as well as to reduce the risk of bilateral asymmetries.

#### **1. Settlement and clearing mechanisms**

4. The establishment of a CU arrangement usually results in an increasing number of cross-border settlements among CU participating countries and other EU countries (i.e. not participating in the CU). In particular, credit institutions increasingly perceive the CU as a single payments market. For this reason, it is very likely that a common platform needs to be developed.

5. The existence of a safe and reliable cross-border payment mechanism is crucial to guarantee a correct functioning of the internal market as well as to a correct implementation of the single monetary

policy. The existence of a centralised CU payment mechanism generates balances amongst participating central banks. The treatment of such balances is analysed hereafter.<sup>1</sup>

### **Current international standards for the statistical treatment of the issue**

6. In traditional systems, most of the balance of payments transactions are settled through payment orders channelled through domestic private banks, which use nostro/vostro accounts with their correspondents located in the relevant counterpart countries to materialise cross-border payments/receipts on their own or their private clients' behalf. In terms of the balance of payments architecture, the double entry structure of the b.o.p., as spelled out in paragraphs 16 to 20 of the Balance of Payments Manual 5<sup>th</sup> edition (hereinafter BPM5), results in offsetting entries for most b.o.p. transactions being recorded in the *Other investment* sub-account of the *banking sector*.

7. In contrast, to the extent that most cross-border transactions inside CUs turn out to be settled through a CU payment mechanism such as the one previously described, the offsetting entry for most b.o.p. flows will turn out to be reflected in the *Other investment* sub-account of the *Monetary Authorities* sector<sup>2</sup>.

8. Every single transaction is recorded in the balance of the two counterpart CU NCB (or the CUCB, where applicable) participating in the payments system.<sup>3</sup> Those balances, which from the national viewpoint have obviously a “cross/border” nature, need to be reflected in the external position of the country. Furthermore, to the extent that the NCBs of countries participating in the EU but not in the CU can also participate in the CU payments mechanism, all balances of CU NCBs/CB vis-à-vis non-CU NCBs will also have a cross-border nature from the point of view of the CU b.o.p./i.i.p.

9. The economic and functional rationale of these balances is similar to that of NOSTRO/VOSTRO accounts. Therefore, their recording in the b.o.p./i.i.p. under *Other Investment/currency and deposits/Monetary authorities* seems consistent with the definition of “*currency and deposits*” provided in paragraph 421 of the BPM5.

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<sup>1</sup> One example of such a clearing and settlement system is, in the case of the European Union, TARGET, which stands for Trans-European Automated Real-time Gross settlement Express Transfer system. TARGET has a decentralised structure which consists of 15 national real-time gross settlement systems and the ECB payment mechanism, which are inter-linked so as to provide a uniform platform for the processing of cross-border euro payments. TARGET is available for all credit transfers in euro between European Union countries, including those European Union countries that have not yet adopted the euro as their currency. It is a gross settlement system in which each payment is handled individually. Acknowledgement of the successful execution of each individual payment order is sent in real time. TARGET processes both inter-bank and customer payments. Although there is no upper or lower value limit for TARGET payments, special emphasis is put on large-value payments related to inter-bank operations.

<sup>2</sup> The transactions/positions between the NCBs and the domestic private banks resulting from these payment orders are purely domestic and, consequently, are not reflected in the national b.o.p./i.i.p.

<sup>3</sup> See an example of the functioning of TARGET accounts and the consequences in terms of balance of payments recording in Annex 1

## Concerns/shortcomings of the current treatment

10. These special balances between NCBs are not explicitly covered as such in the manual though, as previously mentioned, they can be assimilated to other types of correspondent accounts between banks. Following the general principles applicable to all b.o.p./i.i.p. entries, two issues may need further consideration: (i) net / gross recording; and (ii) classification as assets / liabilities.

11. Concerning the first issue, the recording of gross balances vis-à-vis each individual participant in the system would result in an incredibly large amount of entries in the b.o.p./i.i.p. Such a gross treatment would provide a fairly distorting picture. For this reason, net recording of these balances seems appropriate.

12. Assuming that the net treatment is considered acceptable, it might be necessary to clarify whether net balances should systematically be considered as either assets or liabilities or whether their consideration should depend on the sign of the balance (creditor/debtor) at each point in time. This second option might result very complicated on practical grounds. Additionally, allowing these balances to continuously switch from assets to liabilities and vice versa would impede proper reconciliation between transactions and positions.

13. As to whether net balances should be considered as either assets or liabilities by each participant in the system, this decision may basically depend on the specific arrangements of each CU payments mechanism. For instance, in the case of TARGET, at the close of business of TARGET on any day, each non-euro area NCB shall hold a credit aggregate balance vis-à-vis the rest of the system. For this reason, non-euro area NCBs have been instructed to record TARGET positions as *Other investment/assets*, while euro area NCBs record them as *Other investment/liabilities* in the euro area b.o.p. and i.i.p. The decision on the treatment as either assets or liabilities in the national statistics has been left to each individual NCB.

## Points for discussion

*(1) Do members of the CUTEG agree that transactions and positions corresponding to the balances of CU NCBs/CUCB resulting from their participation in the CU clearing and settlement arrangements should be recorded in the b.o.p./i.i.p. under Other Investment/currency and deposits/Monetary authorities? Furthermore, do CUTEG members agree to the proposed treatment on a net basis? Do CUTEG members finally agree that the decision as to whether net balances should be considered as either assets or liabilities (but not continuously switching) should depend on the specific arrangements of each CU payments mechanism?*

## 2. Participation of EU/CU NCBs in the capital of the CUCB

14. Normally, in a CU the NCBs of the participating member states (and to a lesser extent also the NCBs of the non-participating countries) are the shareholders of the CUCB. It is thus necessary to decide how the initial disbursement for the acquisition of the CUCB's shares should be recorded in national and

CU statistics (the latter referring to the holdings corresponding to NCBs of EU member states not belonging to the CU).

### **Current international standards for the statistical treatment of the issue**

15. The special nature of the participation of NCBs in the CUCB's capital does not seem to fit with the definition of either direct investment or portfolio investment. In the case of the NCBs holding more than 10 % of the CUCB capital, such a participation implies neither a lasting interest in the CUCB nor any special control on the decision-making of the institution according to the definition of direct investment in paragraph 359 of the BPM5.

16. In the case of NCBs holding less than 10% of the CUCB capital, CUCB's shares do not match any tradability criteria nor is such an investment driven by any profitability expectations (see relevant references in BPM5 361 and 387). Therefore, the treatment in a residual category such as Other investment could be more appropriate.

17. As to the Other investment instrument to which such holdings could be allocated, not fitting with the definition of either currency and deposits or loans and having a variable remuneration (more comparable to the distribution of dividends of a private company), the treatment in the residual category other assets/liabilities seems most appropriate.

### **Points for discussion**

*(II) Do CUTE members agree to the treatment of the participation in the CUCB's capital under 'Other investment/Assets/Monetary Authority/Other' in the b.o.p./i.i.p. of countries of the shareholder NCBs?*

18. Whatever the treatment finally agreed, it should also be applicable to any purchases/sales of the CUCB's shares resulting from either reviews in the weights of each shareholder (capital keys) or from the accession of new countries to the EU/CU.

### **3. Claims/liabilities resulting from the initial transfer of reserve assets from CU NCBs to the CUCB**

19. In a CU with a single currency, the defence of the currency normally corresponds to the pool of NCBs in charge of executing the single monetary policy of the zone. Therefore, it might well be that part of the reserve assets corresponding to the CU NCBs is pooled so as to permit its use in a co-ordinated fashion in times of financial crises.

20. The share of the total reserves which is pooled may usually be transferred to the CUCB, which is entitled to use it to defend the CU common currency. That is the case of the euro area, where all NCBs belonging to the euro zone initially transferred to the ECB an amount of reserve assets proportional to their respective shares in the capital of the ECB.

21. Proportionate to the reserve assets transferred, the CUCB should recognise a liability vis-à-vis each CU NCB in its balance sheet, which is recorded as a claim on the CUCB in the CU NCB's balance sheet. The main issue is how to treat such a claim (liability from the point of view of the CUCB) in the national b.o.p./i.i.p. of the participating member states.

### **Current international standards for the statistical treatment of the issue**

22. According to BPM5 paragraph 411, *other investment* is a residual category that includes all financial transactions not covered in *direct investment*, *portfolio investment*, or *reserve assets*. Since these claims on the CUCB do not correspond to either category, their consideration as other investment does not pose special difficulties.

23. It might be more open to debate to which other investment instrument these claims correspond, namely whether they should be considered as currency and deposits, loans or other assets. Although highly dependent on the specific arrangements within each CU, a criterion that may be determinant to their final consideration might be whether or not such claims are remunerated at a predetermined rate. In the case of the euro area, the ECB remunerates these liabilities to NCBs on a regular basis and according to a specific reference interest rate. For this reason, the national balance of payments of the euro area member states classify these transactions as *Other investment/Monetary authorities/Assets/Currency and deposits*

### **Points for discussion (summary)**

(III) *Do members of the CUTEAG agree to the proposed treatment for claims of the CU NCBs on the CUCB arising from the initial transfer of reserve assets under 'Other investment/Monetary authorities/Assets/Currency and deposits' as long as such claims are regularly remunerated according to a predetermined interest rate?*

### **4. Reallocation of monetary income**

24. Monetary income can be defined in a simplified way as the income accruing on the assets offsetting domestic banknotes in circulation. The beneficiary of such income is the legal issuer of the domestic banknotes, which, in a normal case, is the monetary authority (in most cases, the NCB).

25. The amount of each NCB's monetary income is determined by its assets held against notes in circulation plus deposit liabilities to credit institutions (the so-called "liability base"). Normally, the amount of each NCB's monetary income is reduced by an amount equivalent to any interest paid by the NCB on its deposit liabilities to credit institutions.

26. The generation of monetary income (as well as the physical putting in circulation of the CU banknotes) normally follows a decentralised approach whereby each NCB generates an amount of monetary income over time. Periodically, for instance, once a year, the pooled monetary income

generated by the CU NCBs (and, where relevant, by the CUCB) is then redistributed among them in accordance with the legal entitlement corresponding to each CU NCB.

27. The final clearing implies that some CU NCBs have to transfer part of the monetary income generated over the year, while some others are entitled to receive money. In turn, the clearing process generates net cross-border payments from some CU NCBs to other CU NCBs.

### **Current international standards for the statistical treatment of the issue**

28. The reallocation of monetary income is a process of redistribution of the pooled income accrued by *Each NCB receives **the difference** between the amount to which it is legally entitled and the amount of monetary income it produces over the year.* International statistical standards provide little guidance as to the treatment of the net transfers resulting from the process of redistribution of monetary income.

29. The fact that normally only net amounts are transferred is central to the statistical consideration of these cross-border flows. In order to decide the correct treatment of these reallocation transactions, it is important to bear in mind that the b.o.p. concept should not apply to the income itself but to the net transfers resulting from the redistribution process.

30. The assets held by each NCB against banknotes in circulation are not necessarily external assets (NCBs could exclusively hold domestic assets) and, if that were the case, this income should not be considered at all in external statistics. For the share of income which corresponds to external assets, appropriate entries will have already been made in the national b.o.p. As a result of the redistribution process, some CU NCBs will have to transfer part of this monetary income, whereas some other will receive net transfers, thus generating cross-border transactions. The b.o.p. concept should exclusively be applied to those redistribution transfers.

31. In some specific cases, for instance if the CUCB acts as clearinghouse in the redistribution process, this process might be interpreted as if it were an ex-ante redistribution of the CUCB profits. However, these net payments do not directly result from the investment in the CUCB: the monetary income will be redistributed regardless the final annual results of the CUCB. In addition, the net transfer that each CU NCB has to pay/receive as a consequence of the reallocation process is only a small part of the total gross amount to which each CU NCB is actually entitled. The treatment as income could lead to a situation whereby those CU NCBs which systematically generate more income than the amount to which they are entitled would permanently show negative income in the bop. Against this background, the treatment of these transfers as income does not appear as recommendable.

32. BPM5 (paragraphs 291-293) provides two criteria to determine whether cross-border flows can be deemed to fall in the category of current transfers: (i) an economic value should be provided (even when no quid pro quo is received); and (ii) no economic value (i.e. real resources or financial items) is placed on the benefits provided/received. Both criteria seem to be compatible with the process of redistribution of monetary income.

## Points for discussion (summary)

(IV) Do CUTE members agree to the proposal to treat cross-border transactions resulting from the monetary income reallocation process as redistribution transfers and thus record them under 'Current account/current transfers'?

### 5. Remuneration of intra-EU NCBs balances (including those arising from settlement and clearing arrangements)

48. The CU NCBs/CUCB may hold claims and liabilities vis-à-vis all other CU NCBs/CUCB as a result of the conduct of a single monetary policy, foreign exchange operations, the operation of settlement and clearing arrangements (see section 1) and any other financial transaction.

49. Examples of these balances are (i) balances arising from the participation of CU NCBs/CUCB in the CU settlement and clearing arrangements, (ii) correspondent accounts, i.e. balances held on accounts which the CU NCBs or the CU CB have opened to each other outside settlement and clearing arrangements; or (iii) loro accounts, i.e. accounts which the CU CB or a CU NCB open in their books in the name of another CU NCB or the CU CB.

50. All these balances may not only be held with counterparts inside the CU, but also vis-à-vis NCBs of countries participating in the EU but not in the CU. These balances give rise to cross-border transactions and positions, even from the point of view of the CU b.o.p./i.i.p. aggregate.

51. Normally the remuneration of these balances is calculated periodically (e.g. monthly) by netting out all credit and debit balances vis-à-vis the rest of CU NCBs/CUCB. The net proceeds are then distributed via net transfers settled through the CU settlement and clearing arrangements.

52. In addition, income accrued on the balances analysed in sections 2 and 3 of this note (namely (i) balances arising from the contribution of CU NCBs to the capital of the CU CB; and (ii) balances resulting from the initial transfer of foreign reserves to the CU CB) can be deemed subject to the same rules.

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

53. The specific b.o.p. item on which such net transfers shall be recorded does not seem to pose substantial problems. Following BPM5, paragraph 281 and under the general proposal of section 1 applicable to the balances resulting from clearing and payment mechanisms, namely recording such balances under *Other investment*, the recording of related income as *Other investment income* appears to be straight forward.

54. Whether to treat such remuneration on a gross or on a net basis might be more debatable. The general b.o.p. principle of recording transactions on a gross basis (as stated in BPM5, paragraph 192) seems clear. The only case which might be an exception is quoted in section 1 of this paper. Indeed, section one described the difficulties that a gross treatment of intra CU balances would trigger in the case



of settlement and clearing arrangements. For the sake of consistency, income accrued on those balances should most likely also be recorded on a net basis.

**Points for discussion (summary)**

*(V) Do members of the CUTEG agree to the proposal to treat income on intra CU NCBs/CUCB balances on a gross basis under 'Current account/investment income/income on other investment', with the exception of the remuneration of balances related to settlement and clearing arrangements, which should be recorded on a net basis?*

## **Annex 1: Functioning Of Target Accounts**

- In the framework of a standard payment system, each payment entails two entries in the balance sheet of the correspondent bank through which the payment is settled: a debit entry in the account of the payer and a credit entry in the account of the beneficiary.
- In TARGET, **all ESCB participants play the role of correspondent for each other.**
- For instance, a payment from a German MFI to a UK bank channelled through TARGET would give rise to the following entries in the balance sheet of the two NCBs involved:

### Bundesbank:

- i) a debit entry in the account of the German MFI (i.e. a domestic relationship, not relevant for b.o.p. purposes);
- ii) a credit entry in the TARGET account of the Bank of England

### Bank of England:

- i) a credit entry in the account of the UK bank (not relevant for b.o.p purposes);
  - ii) a debit entry in the TARGET account of the Bundesbank.
- The respective TARGET accounts of both parties involved (i.e. the Bundesbank and the Bank of England) **mirror each other**. Any entry reflected in these balances is a claim for one central bank and a liability for the other.

Most external payments have habitually been settled via domestic MFIs, which subsequently channelled these payments through their nostro/vostro accounts in non-resident correspondent banks. Therefore, the offsetting entries for most b.o.p. flows have traditionally been recorded in the “Other investment” of the MFI sector. Instead, the widespread use of TARGET as a means of payment implies that part of the b.o.p. flows will be offset by the b.o.p. item “Other investment” of the Monetary authorities sector.

# Bundesbank

