

NEW APPENDIX: FREQUENTLY ASKED QUESTIONS ON THE CHARACTERISTICS OF RESERVE ASSETS

1. This appendix provides Frequently Asked Questions (FAQs) to assist countries in identifying reserve assets under international standards, consistent with the recommendations of the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)*.

2. *BPM6*, paragraph 6.64, defines reserve assets as follows: “Reserve assets are those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing).”¹

3. To qualify for classification as a reserve asset, the asset must be:

- a claim on a nonresident or in gold bullion of significant purity (*BPM6*, paragraph 6.65 and 6.78);
- owned or under direct and effective control of the monetary authorities (*BPM6* paragraph 6.67);
- readily available in the most unconditional form (i.e., be liquid) (*BPM6* paragraph 6.69)
- denominated and settled in convertible foreign currencies that are freely usable for settlements of international transactions (*BPM6* paragraph 6.72);
- of high quality (in general) (*BPM6* paragraph 6.70).

4. Some elements of the definition of reserve assets can be applied objectively while some others require informed judgment. For example, determining whether a claim is on a nonresident usually can be determined objectively. However, determining whether a claim is sufficiently liquid to qualify for reserve asset classification is partly judgmental.

5. More guidance on the above characteristics, particularly on those that require judgment, is presented in the following FAQs.

¹ There are no substantive differences in the definition of reserve assets between the fifth and sixth editions of the *Balance of Payments Manual*.

Question 1: A reserve asset must be a claim on a nonresident or in gold bullion of sufficient purity. Are there any circumstances where claims denominated in foreign exchange on domestic banks can be regarded as reserve assets?

6. In accordance with the residence concept, reserve assets, other than gold bullion, must be claims on nonresidents (*BPM6*, paragraph 6.65).² The authorities' foreign currency claims on residents, including claims on resident banks are not reserve assets.

7. However, there may be cases where institutional units other than the monetary authorities (such as domestic banks) hold legal title to external foreign currency assets, and such external assets can be considered reserve assets under the following conditions:

- the resident entity can transact only in those claims with nonresidents on the terms specified by the monetary authorities or only with their express approval; **and**
- the authorities have access on demand to these claims on nonresidents to meet balance of payments financing needs and other related purposes; **and**
- a prior law or an otherwise legally binding contractual arrangement confirms this agency role of the resident entity that is actual and definite in intent.

8. In the above circumstances, it is not the claim on the resident that is included in reserve assets, but instead it is the resident's claim on a nonresident that is regarded as a reserve asset, because the latter claim is under the direct and effective control of the monetary authorities.

9. In the Reserves Data Template, liquid foreign currency claims on residents that do not meet the criteria for reserve asset treatment should be included in Section I.B of the template, "other foreign currency assets (specify)."

Question 2: A reserve asset must be readily available for meeting balance of payments financing needs. Some types of arrangements with the IMF, such as Flexible Credit Lines (FCLs) and Precautionary Credit Lines (PCLs) are readily available for meeting balance of payments financial needs. Are these reserve assets?

10. Paragraph 6.65 of *BPM6* states that reserve assets must be foreign currency assets that actually exist. Contingent or potential assets, such as undrawn lines of credit, are not assets and so therefore they also are not reserve assets. Undrawn, unconditional credit lines should be recorded in Section III of the Reserves Data Template. As described in the Guidelines

² Gold bullion is an asset but it is not a claim, because no other entity has a corresponding liability.

(paragraph 216), in general, IMF arrangements are conditional lines of credit and thus should not be included in Section III of the Template. Both the FCL and PCL have conditions for access, but the qualification criteria must be met *before* either credit line is approved and, once met, the member can draw down funds. For the PCL, there are review dates. So the undrawn amounts of these facilities should be included in Section III from approval to the maturity of the facility for the FCL, and from approval up until the next review date for the PCL.

Question 3: The definition of reserve position in the IMF states that it includes “...any indebtedness of the IMF (under a loan agreement) in the General Resources Account that is readily available to the member country...” (BPM6 paragraph 6.85). What is the treatment when institutional units or parts of members (such as a central bank or a ministry of finance) holds the claim on the IMF, rather than the (entire) member country itself?

11. In some circumstances, an institutional unit or part of a member may provide financing to the IMF in the form of loans, notes, provision of financing to the GRA, etc. In this circumstance, the claim should be included in the reserve position in the IMF provided that it is readily available to the member country at the time that the member represents that it has a balance of payments need.

Question 4: Reserve assets must be readily available for meeting a balance of payments financing need. Can you clarify what this means? For example, if an external claim can be sold for a reserve asset currency, with settlement of the transaction occurring within a few weeks, is the claim sufficiently liquid to qualify as a reserve asset?

12. The IMF does not specify a firm time period for meeting the reserve asset “readily available” requirement. The IMF has received questions from members over many years regarding specific external claims that are held by its members. In reply to these questions, the IMF has said that, if an external claim can be converted into a reserve asset currency to meet a balance of payments need only within several weeks, that is not sufficiently rapid for the external claim to qualify as a reserve asset, in consideration of the speed at which balance of payments crises could develop. Further, provided reserves are available at very short notice for times when they are needed most, the IMF has also said, the external claim that can be converted into a reserve asset currency to meet a balance of payments need within a few days, could meet the readily available requirement.³

³ In addition, paragraph 6.69 of *BPM6* states that the ability to raise funds by using an asset as collateral is not sufficient to qualify an asset as a reserve asset.

Question 5: We have seen the terms convertible currencies, usable currencies, and freely usable currencies used from time to time. Can you clarify the definitions of these terms. In particular, does the IMF maintain lists of each?

13. Currently the IMF does not maintain a list of convertible currencies. In 1978, the IMF implemented the Second Amendment of the IMF's Articles of Agreement and discontinued using this term, and introduced the terms "usable currency" and "freely usable currency."

14. For Fund purposes, a usable currency is a member's currency used in the IMF's Financial Transactions Plan (FTP). Currency selection is based on judgments about the external positions of members. The most current list is available at: http://www.imf.org/cgi-shl/create_x.pl?ftp. Please note that this is a list of "usable" foreign currencies, whereas reserve assets must be denominated and settled in a "freely usable" foreign currency.

15. In regard to the definition of a freely usable currency, Article XXX of the Articles of Agreement of the IMF mentions, in Paragraph (f), that "A freely usable currency means a member's currency that the Fund determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets." Decision No. 11857-(98/130) of December 17, 1998 says that "Pursuant to Article XXX (f), and after consultation with the members concerned, the Fund determines that, effective January 1, 1999 and until further notice, the euro, Japanese yen, pound sterling, and US dollar are freely usable currencies."

16. The above may help to highlight a divergence between the IMF's operational use of the term, "freely usable currency", and the statistical definition of that term. As noted, for operational purposes, the Fund determines the currencies that it considers to be freely usable, and, at present, they are the four SDR basket currencies. In contrast, *BPM6* states: "The term "freely usable" is not used in a restrictive sense to cover the currencies in the SDR basket only."⁴ This recognizes that other currencies may be freely usable. Nonetheless, in practice, the overwhelming majority (well above 95 percent at the present time) of reserve assets reported in the template are denominated in SDR basket currencies. Countries are required to disclose at least once each year the composition of reserves by groups of currencies (i.e., currencies in the SDR basket, and currencies not in the SDR basket) – see item IV.(2)(a) of the Reserves Data Template.

⁴ *BPM6*, paragraph 6.72, footnote 7.

Question 6: Reserve assets should be of high quality. Can you explain what “high quality” means?

17. *BMP6*, paragraph 6.70, clarifies that “To be readily available to the authorities to meet balance of payments financing needs and other related purposes under adverse circumstances, reserve assets generally should be of high quality.” The *BPM6* discussion implies that securities included in reserve assets should generally be of high investment grade, because such securities can be converted to a freely usable foreign currency under adverse circumstances without substantial delay or loss in market value. As noted in paragraph 89 of these *Guidelines*, countries should indicate in notes accompanying the release of their data if reserve assets include securities below investment grade.