Seventeenth Meeting of the
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Report of the Technical Group on Third Party Holdings

Prepared by the Statistics Department
International Monetary Fund

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I. EXECUTIVE SUMMARY

In 2001, the IMF Committee on Balance of Payments Statistics, as part of the ongoing work on the Coordinated Portfolio Investment Survey, set up the Working Group on Third Party Holdings (WGTPH). The role of the WGTPH is to explore avenues for measuring holdings by residents of securities held on their behalf by nonresident custodians. This paper provides a progress report on the work of the WGTPH. It reports on (a) the meeting of the WGTPH, held in Frankfurt, May 2004; (ii) discussions with the Swiss National Bank on TPH; and (iii) work that has been undertaken as a result of the meeting in Frankfurt.

The meeting in Frankfurt proposed that participating members of the WGTPH undertake some preliminary discussions with custodians and those in the private banking industry. Discussions at the Swiss National Bank indicated that Swiss custodians have substantial third party holdings for individuals, but that the information is not available on an individual country breakdown. Preliminary exploratory discussions in the United States have so far been somewhat disappointing but work will continue.

II. SUMMARY OF MEETING OF WGTPH, HELD IN FRANKFURT, MAY, 2004

A. Benefits from Third Party Reporting as a Partner Country Data Source

Most countries represented at the meeting recognized that there are likely to be significant gaps in the coverage of the household sector in their CPIS, and that they are likely to be potential beneficiaries from reporting of Third Party Holdings (TPH) by other countries. This was also the finding of the final report of ECB’s Task Force on Portfolio Investment Collection Systems (Task Force), June 2002, which was chaired by Mr. Chaudron. Mr. Chaudron recalled that, in light of this finding, the Task Force saw potential benefit from an annual Third Party Holdings (TPH) Survey confined to households, especially if this could be expanded to include non-euro area countries. To this end, the Task Force recommended a feasibility study which, if successful, should be followed by a pilot survey.

1 The following participated in the meeting in Frankfurt: Mr. Simon Quin, IMF, (chair), Mr. John Joisce (IMF), Mr. Jean-Marc Israel (ECB), Mr. Peter Neudorfer (ECB), Mr. Sanchez Munoz (ECB), Mr. Dominique Rouges (France), Ms. Judith Hohler (Germany), Mr. Frank Fong (Hong Kong SAR), Mr. Kam Tim Chau (Hong Kong SAR), Mr. Luca Buldorini (Italy), Mr. Hidetoshi Takeda (Japan), Mr. Raymond Chaudron (Netherlands), Mr. Simon Humphries (United Kingdom), Mr. Robert Westwood (United Kingdom), Mr. William Griever (United States), Mr. Leon Taub (United States), Ms. Debra Kuntz (United States).
Mr. Israel indicated that although no action has been taken, the recommendations of the Task Force remain valid and could be implemented in conjunction with recommendations made by the WGTPH. Moreover, since there is potential benefit to euro area international investment position statistics from TPH reporting by non-euro area countries, he was receptive to the idea that the ECB act as a coordinator in collecting TPH data from member countries (such as Luxembourg) needed by non-euro area countries to improve their CPIS. This approach could be followed in both the feasibility study and the pilot survey.

It was recognized that many financial center countries important to the TPH may be reluctant to participate in such surveys, and that their participation may be gained only after a considerable period of time and patient effort.

**B. What can be Learned From Existing Custodian Reporting**

The meeting discussed the availability of data on holdings of foreign securities by the household sector. Since it is generally not feasible to collect data from the household sector directly, country asset surveys tend to collect data either from domestic institutional investors, domestic custodians, or both. Thus, holdings of the household sector that are neither made through domestic institutional investors nor entrusted to domestic custodians will not be measured. In such cases, household sector investors in country A can either purchase securities of country B and entrust these securities directly to custodians in country B (second party holdings), or they can entrust their holdings of country B securities to a custodian in country C (third party holdings). Since country A authorities cannot measure such holdings, the question was to what extent, if at all, can data be collected on holdings of country A’s household sector from custodians in country B or country C, and then provided to compilers in country A?

In support of the work of the Task Force, some euro area countries conducted a survey of custodians to determine whether nonresident households were likely to be significant holders of securities issued by residents (two-party holdings). For France, Germany, Italy, and Netherlands, it was determined that the overwhelming proportion of portfolio investment liabilities comprised securities held in a custodian chain rather than the ultimate beneficial owner (98 percent in the case of Germany). For these four countries, the only data available for securities held by custodians for nonresident ultimate beneficial owners was for Italy (about US$4 billion).

The United States was able to obtain some very preliminary and not necessarily representative data on the holdings of U.S. liabilities by foreign residents (second party holdings) through the private banking units of three major U.S. banks. It was thought that if foreign individuals held assets in the United States as individuals (as opposed to through mutual funds, investment companies, etc.), the bulk of these holdings would be in the private banking units of major U.S. banks. The results indicated that (i) holdings in these units for the three major U.S. banks were very small (1–2 per cent), relative to the total second party portfolio investment liabilities reported by those institutions in the U.S. Portfolio Investment Liability Survey; and (ii) the bulk of these holdings were from accounts in “offshore”
jurisdictions such as the Caribbean, Luxembourg, and Switzerland (evidenced by the fact that 60 per cent of the holdings were from accounts in the Caribbean and more than half of the 24 per cent of the holdings by residents of European countries were holdings by residents of Luxembourg and Switzerland.) A more complete fact-finding study covering nonresident individuals’ holdings of both U.S. and foreign securities along the lines suggested by the WGTPH is to be undertaken.

No information was available for the United Kingdom, as there is no custodian reporting.

C. Reporting by Nonresident Individuals

It was agreed that work on TPH should focus on securities held by individuals and not be restricted to high worth individuals. It was further agreed that the relevant institutions for completing a TPH survey should include custodians, private banks (defined as banks that provide investment management services but do not provide custody services), and other nonbank financial institutions (such as brokers/dealers and investment companies) that provide investment management services. CPIS compilers might wish to introduce reporting thresholds to reduce reporting burden, but the classification of ultimate beneficial owners should focus on individuals within the sector classification (e.g., government, corporate, individuals, other). It was agreed that further work is needed to explore the sector classifications commonly followed by custodians.

It was noted that individuals could open custody accounts in the name of a nominee, trust, partnership, closed mutual fund (such as a hedge fund), or international business company, as a means of seeking confidentiality. For some of these, application of the know-your-customer principle might facilitate identification of the ultimate beneficial owner. It was noted that this information might be available only in hard copy files and, therefore, would not be available for reporting by custodians on a global basis without significant costs. This is one topic to be investigated during the proposed fact-finding investigation. It was agreed that it would be important to ensure that CPIS principles are followed in determining the residence of trusts, partnerships, closed-ended mutual funds, and international business companies, as it may not be appropriate for the purposes of the CPIS to see through them.

D. Reporting by Private Banks/Investment Companies

For some countries, there was concern that brokers/dealers, investment companies, and private banks that manage the accounts of individuals may use the services of custodians in their own name. In such instances, custodian reporting may not be sufficient for reporting TPH by nonresident individuals, and an effort may need to be made to identify these institutions for the purpose of determining respondents to a TPH survey. It was evident that the organization of the custody and investment management industries varied among countries.

For the United States and Hong Kong SAR, in particular (and possibly the United Kingdom and the Netherlands), it was considered important to investigate whether a custodian survey
should be supplemented by a survey of private banks and relevant nonbank financial institutions.

For France, Germany, and Italy, it was considered likely that private banks/investment companies would use the services of resident custodians and that resident custodians could always see through securities held with them. It was considered unlikely that private banks/investment companies would use the services of nonresident custodians. However, it was recognized that further inquiry would be useful to confirm or deny the assumption that banks and investment companies with substantial investment departments were not managing securities for nonresident individuals.

E. Reporting by Global or National Custodians

Consideration was given to asking custodians to report securities held by nonresident individuals with their branches/subsidiaries abroad. It was recognized that, in practice, this would not be feasible for a variety of practical and legal reasons. It was, therefore, concluded that a TPH survey should be conducted on the basis of national reporting as a supplement to existing national reporting.

F. Which Countries Should Participate

It was agreed that all members of the WGTPH would participate in the fact-finding studies, which should be completed by end-December 2004. Depending on the outcome of the fact-finding studies, the WGTPH could determine which countries are interested in bilateral exchange and how best to proceed. No decision was made on whether there should be a second meeting of the WGTPH. It was agreed that the need for a second meeting could be addressed following the outcome of the fact-finding studies.

G. Legal and Confidentiality Issues

All countries expressed concern about their legal authority to collect data on third party holdings, as their legal authority was limited to the collection of data needed for national statistical ends. However, there was general agreement that the collection of data on second party holdings presented far fewer legal difficulties. It was agreed that this issue would need to be explored further in the fact-finding studies. Countries would determine whether they do have legal authority if the data to be collected are exchanged for partner country data that are needed for international investment position compilation, and, if not, what steps would need to be taken.

It was recognized that confidentiality issues might arise in the case of custodians that may be reluctant to report the nonresident ultimate beneficial owner of securities held in custody, or in the case of investment companies that are reluctant to report the nonresident ultimate beneficial owner of securities they manage. In general, it was recognized that the ability/willingness of custodians or investment companies to report data on nonresident
individuals may depend on their country’s know-your-customer rules. This would be an issue to explore further in the fact-finding studies.

It was recognized that confidentiality issues might arise in the case of countries that are reluctant to indicate the size of third party holdings held with their custodians or reluctant to indicate the size of such holdings by nonresident individuals. This was not a concern expressed by countries represented at the meeting, but might be a concern by other countries considering participating in a TPH survey. It was agreed that such concerns could be met through confidential reporting to the ECB (for euro area countries) and to the IMF (for other countries) and by agreement that the published data on TPH would comprise a matrix of all securities held by nonresident individuals broken down by the country of residence of the issuer and the holder, without reference to where securities are held in custody.

H. What Further Information is Needed

As a prior step towards determining the feasibility of conducting a TPH survey, the WGTPH agreed that a fact-finding study be undertaken comprising a list of issues that need to be investigated further by the participating countries. As a first step, these fact-finding studies should find out what know-your-customer rules are applied by custodians and investment companies/private banks and how these can support statistical reporting. Subject to this, the fact-finding studies would (i) explore the classification systems followed by custodians, private banks, investment companies, and other nonbank financial institutions likely to be involved in providing investment management services to nonresident individuals in categorizing investors (such as government, companies, individuals, other); (ii) determine how nonresident individuals are identified, including the residence of individuals for tax purposes (or if not identified, what would be required to collect such information), whether nonresident individuals as ultimate beneficial owners can be identified, and whether the country of residence of nonresident individuals can be identified; (iii) clarify whether there is adequate legal authority to collect statistics needed by a TPH survey, whether there is adequate legal authority to exchange data with other countries, and whether steps would be needed to provide adequate authority; and (iv) determine the scope of their TPH survey (e.g., whether targeted at some or all custodians, private banks/investment companies, or some combination of both). It was expected that these fact-finding studies should be completed by end-December 2004.

III. DISCUSSIONS WITH THE SWISS NATIONAL BANK, ZURICH, MAY, 2004

Discussions were held with the Swiss National Bank (SNB), in Zurich, May, 2004, immediately following the meeting of the WGTPH.

The SNB conducts a survey of custodians on all securities held by Swiss custodians. Reporting is on a national (resident) basis and differs from data published by Swiss banks which are commonly on a consolidated basis. From the survey it is possible to break down the total value of securities held by Swiss custodians into (i) holdings of domestic securities by Swiss residents; (ii) holdings of foreign securities by Swiss residents; (iii) holdings of
Swiss securities by nonresidents; and (iv) holdings of foreign securities by nonresidents. For (iii) and (iv), information is also available on whether the nonresident holder is an institutional investor (insurance company, pension fund, investment fund, bank/custodian), a commercial investor (nonfinancial company), or a private investor. Nonresident private investors are said to largely correspond to nonresident ultimate beneficial owners, and nonresident ultimate beneficial owners are said to largely comprise nonresident individuals. The total value of securities held on behalf of nonresident noninstitutional investors amounted to about US$500 billion at end-December 2003. Data on custodian holdings is published on the web site of the Swiss National Bank (www.snb.ch/Publication/The Banks in Switzerland/ The Banks in Switzerland 2003, Complete publication in German or French, table 38a-c).

Switzerland is currently not willing to collect geographic breakdowns of its holdings of securities, except on the asset side, for the purposes of the CPIS. Moreover, the Swiss National Bank does not see prospective benefit from a TPH survey conducted by other countries, as it considers that the Swiss household sector is fully covered by existing custodian reporting. It was agreed to keep the Swiss National Bank informed of the work of the WGTPH.

IV. INITIAL FACT FINDING WORK

Following the meeting of the WGTPH in May, the members of the WGTPH from the United States prepared a short questionnaire (Appendix 1) to be used as the basis for discussions with some custodians. In September, 2004, meetings were held with two custodians. The outcome of these discussions proved somewhat disappointing as the representatives from the custodians were not as knowledgeable about their institution’s activities with respect to high net worth individuals as was hoped and anticipated. However, one of the issues that recurred throughout the meetings was the definition of “individual”; both custodians indicated that high worth individuals may use other investment vehicles (such as personal trusts) which would not be captured as “individuals” in the current approach. The custodians felt that there could be considerable amounts held through these vehicles.

Further contacts are being considered.

V. SECOND PARTY HOLDINGS

The United States has made an in-principle decision to include in its June 2005 portfolio investment liabilities survey a separate vector of holders to identify “foreign individuals”. Such information represents potentially very valuable input to other countries’ portfolio investment assets.
VI. LEGAL AUTHORITY

The Legal Department of the Federal Reserve Board has ruled that the current legislation in the United States is sufficient to collect third party holdings, provided there is a quid pro quo from other countries to supply the United States with comparable information. This is the first time that a country had been given clear legal authority to proceed.

Questions for the Committee

1. Does the Committee endorse the direction that the WGTPH is adopting? Does it have any additional guidance on how to proceed?
Questionnaire prepared by the New York Federal Reserve Bank and the Federal Reserve Board for initial discussions with custodians on third party holdings

A. Background

The primary source for U.S. holdings of foreign securities data (collected on Form SHC) is U.S.-resident custodians (including broker/dealers). This is supplemented with data reported by large U.S.-resident end-investors where no U.S.-resident custodian is used. A known gap in this data collection methodology is small U.S.-resident end-investors, including individuals, where no U.S.-resident custodian is used. Expanding the data collection effort to include all possible U.S.-resident end-investors is not cost-effective. In addition, the United States does not have the legal authority to collect data directly from the foreign-resident custodians that are safekeeping securities directly for small U.S.-resident end-investors. This same data collection gap exists for all countries. Therefore, the International Monetary Fund (IMF), in conjunction with the European Central Bank (ECB), have proposed expanding the data collection effort to include third party holdings (TPH) data, which would be shared, on an aggregate basis, with the appropriate countries.

From the United States’ perspective, a TPH occurs when a foreign resident directly employs a U.S.-resident custodian to safekeep a foreign security. For example, a Venezuelan resident directly safekeeps its German securities with a custodian in the USA. The Venezuelan resident would not report its holdings (i.e., its claims on the German issuers) to the Central Bank of Venezuela because it is not a custodian and not a large end-investor. Each German security issuer would report the foreign holdings of its securities (i.e., its liabilities to foreigners), but would probably indicate the United States as the country of foreign holder, since that is where the securities are held in custody. Therefore, worldwide reported liabilities would be (and, in fact, are) larger than worldwide reported assets.

The U.S.-resident custodian does not report these securities to the FRBNY because they are foreign securities owned by a foreign resident. If the Treasury were to expand data collection to include these TPH then, in the example above, the United States would be able to provide aggregate information to Venezuela to increase their assets data and provide aggregate information to Germany to correct their liabilities country attribution. Likewise, the United States would receive information from other countries to improve its portfolio investment data.

To reduce the possibility of double counting data that has already been collected, the proposed TPH data collection effort is focused solely on individuals’ securities holdings. It would be very difficult to identify small end-investors that are not individuals and not already part of a particular country’s data collection effort. For example, the reporting panel for the United States’ SHC data collection is confidential and cannot be shared with other countries. Therefore, there would be no way for other countries to identify which small end-investors are already on the United States’ SHC reporting panel. However, individuals are not on the
United States’ SHC reporting panel. This is also the case for other countries’ reporting panels. Therefore, double counting is highly unlikely.

**B. Questions**

1. Can individuals be identified and their securities holdings be reported separately from non-individuals?

2. If so, what criteria do you use to identify a client as an individual?

3. What are the obstacles (if any) to reporting foreign individuals’ holdings (by country) of foreign securities on a security-by-security basis?

4. Are there any advantages to adding foreign individuals’ holdings of foreign securities to the SHL report rather than adding to the SHC report? The changes that would result if such reporting were added to the SHL or SHC report are summarized in the following table.

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<td>If TPH added to SHC</td>
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5. What is the approximate market value of foreign individuals’ total holdings and holdings of foreign securities currently held in your custody?

6. How are custody accounts initialized in your organization? For example, can individuals set up an account directly with a Grand Cayman subsidiary of your organization or are all custody accounts created in the United States?

7. When a client that is an individual employs your organization as an investment manager, but the securities are not held in your custody, is the security account at the custodian in the name of the client or your name? If your name, is the custodian provided with any client information, such as country of residence or that the client is an individual?
8. Do your information systems allow your organization to “look through” custody accounts to determine if the beneficial owner of the securities is an individual versus the individual’s investment manager?

9. When individuals transfer their assets into a trust, limited partnership, or other vehicle, does your organization identify this as holdings by an individual or holdings by a non-individual?

10. To what extent do individuals transfer their assets into these vehicles?

11. Given what we’re trying to accomplish, do you have any advice as to how we should go about collecting the data?