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Secretariat

REVIEW OF THE DISCLOSURE TEMPLATE REGARDING THE AUTHORITIES' FOREIGN CURRENCY LIQUIDITY POSITION

Summary of the conclusions by the technical experts

I. Introduction

The report on "Enhancing transparency regarding the authorities' foreign currency liquidity position", prepared by a working group established by the ECSC, proposed a template for the disclosure of this position. In the report's recommendations, it was acknowledged that "some specific presentational issues are still outstanding", in particular in two areas: "the best way of applying the proposed valuation principles to derivative instruments and the clarification of the relationship between the items singled out for disclosure and those currently identified in international balance-of-payments guidelines". It was agreed that technical experts would review these questions as soon as possible**.**

Four basic principles guided the review of the template: (i) maintaining its internal consistency, in particular as concerns the emphasis on foreign currency liquidity; (ii) attempting to reconcile the template to the extent possible with the proposals under discussion at the IMF and with existing reporting practices and conventions; (iii) designing the template as a self-contained document, in the sense that it should be understandable without the report; and (iv) avoiding excessive complication.

This note summarises the main issues addressed and the proposals for clarification and changes to the template, which is attached as an Annex.

The main proposals are the following:

- *Concerning the sectoral coverage, to define the reporting sector in a way similar to the IMF template: monetary authorities and other central government, excluding social security.*

- *To group (net) drains (inflows and outflows, shown separately, as before) into two broad categories, namely predetermined and contingent flows (items II and III of the new template respectively).*

- *To make it clear that only instruments settled in foreign currency should be included in categories I to III, whereas instruments denominated in foreign currency or involving foreign currency in their denomination, but settled in domestic currency, should be reported in category IV (memo items).*

- *On the disclosure of options, the main decisions were the following:*

  (i) *To treat options similarly to forwards and futures.*

  (ii) *To emphasise the distinction between short and long positions in the presentation of the information.*

  (iii) *To disclose the notional value of the overall short and long position and the notional value of in-the-money options, in both cases for three time horizons: one month, three months and one year. A sensitivity analysis of the notional value of in-the-money options (short and long positions) under several exchange rate scenarios (for example, ±5% and ±10%) would be added. The market value of the position in options would be disclosed – together with the market value of other derivatives – under category IV (memo items).*

II. General issues

II.1 The residence criterion

The old template emphasised the distinction between institutions headquartered and those not headquartered in the reporting country, instead of the more traditional criterion of residence. While this distinction was made for deposits, it was not made for other assets. The technical experts reviewed both topics.

On the first issue (headquartering vs. residence) it was decided to maintain the approach of the template. The rationale for the disclosure of this information was related to the possibility of the authorities exerting an influence on these institutions' strategies or, in a crisis situation, being concerned about the impact of central banks' operations on the solvency of domestic institutions. In view of this, the headquartering criterion seemed more useful, although in practice positions would normally be very similar under both definitions. In order to help in reconciling with the IMF template, *it is also proposed, in the case of deposits, to add a category (banks headquartered outside the reporting country* of which *located in the reporting country) that would make it possible to calculate positions according to the residence criterion.*

On the issue of whether to confine the headquartering breakdown to deposits or to extend it to other assets, it is proposed to add a category in the case of securities, in order to limit potential circumvention. Nevertheless, for the sake of simplicity, such detail would not be required for other assets, with the understanding that when sizable *amounts vis-à-vis residents (or domestic-headquartered institutions) existed, they would be reported in the memo items*.

II.2 Sectoral coverage

One important aspect of the reconciliation with IMF statistics is the sectoral definition of the reporting entity or entities. The sectoral coverage of the ECSC template (central banks, other monetary authorities and relevant public sector entities) was defined in a slightly different way from the IMF template (monetary authorities and other central government, excluding social security). The ECSC report states that the template is intended for "all public sector entities that would be responsible for, or involved in, counteracting currency crises. In practice, this should at least include the monetary authorities, **defined here** to include both the central bank and the central government (excluding social security), but depending on institutional arrangements could extend to other public sector entities". The IMF Balance of Payments Manual # 5 defines monetary authorities as "a functional concept", including "the central bank institutional unit (or currency board, monetary agency, etc.) and certain **operations** that are usually attributed to the central bank but, in some cases, are carried out by other government institutions (or, in some instances, by commercial banks). Such operations include the issue of currency, maintenance and management of international reserves … and the operation of exchange rate stabilization funds". One may conclude that the intended sectoral coverage is the same in both exercises. However, the differences in presentation raised several issues:

1. The definition of monetary authorities, which in the case of the old ECSC template departs from balance-of-payments conventions. It seems advisable to use a concept closer to statistical conventions, especially if the template is intended as an independent document, and no longer as an annex to the report.

2. The definition of the reporting sector, which, although intended to be the same in both templates, may be subject to some ambiguity, depending on the interpretation of institutions "counteracting currency crises" in the ECSC exercise and on the scope of the functional concept of the BOP Manual. It seems safer to attempt to approximate the definitions as much as possible.

The proposal is to use the IMF wording for the definition of the reporting sector: "monetary authorities and other central government, excluding social security". This definition, using the IMF concept of monetary authorities, would be equivalent to the sectoral coverage intended in the ECSC template.

II.3 The means of settlement

The focus of the exercise was originally related to the on and off-balance-sheet foreign currency activities of the authorities. Some financial instruments may be denominated in foreign currency (or indexed to the exchange rate) but settled in domestic currency, or vice versa. As concerns future inflows and outflows arising from the authorities' contractual obligations, only instruments settled in foreign currency could either add to, or detract from, liquid resources. Other instruments, including those either denominated in foreign currency or with a value linked to foreign currency (such as foreign currency options), but settled in domestic currency, would not **directly** affect liquid resources in foreign exchange. However, the report acknowledged that "instruments settled in domestic currency but indexed to foreign currency merit a special mention", since "indexed liabilities can represent a major source of indirect pressure on reserves during a crisis". Futures and non-deliverable forwards as well as instruments with a foreign exchange guarantee were mentioned in this context, although only the debt indexed to the exchange rate was finally included in the template as a memo item.

The exclusion from the template of instruments denominated in foreign currency but settled in domestic currency would create an incentive for their use in place of instruments denominated and settled in foreign currency, though their economic rationale would be similar. *To avoid this type of incentive, while at the same time safeguarding the consistency of the template, the recommendations are: (i) to limit disclosure under categories I, II and III to instruments settled in foreign currency and (ii) to add a memo item (IV-1-b) which would cover financial instruments denominated in foreign currency – or involving both domestic and foreign currency in their denomination – but settled in domestic currency. Information on this memo item would be broken down by types of instrument.*

II.4 The maturity threshold

The notion of drains included in the template (referring to both inflows and outflows at a future date) is confined to the short term (one year), whereas the template proposed by the IMF includes, as optional, the possibility of having longer maturities. *Consistently with the focus on liquidity, it is proposed to keep the maturity threshold of one year for the drains, although central banks are obviously free to disclose longer positions if they wish. In the case of debt with maturity longer than one year, interest payments within the agreed threshold of one year would be reported. Deposits "on call" would be added to the shortest maturity category (although it is proposed at the same time to drop the breakdown of deposits by maturity from the template, for the sake of simplicity). The reporting of guarantees would be confined to those of debt with maturity shorter than one year. Where there are penalising clauses, they should also be reported.*

II.5 The distinction between contingent and predetermined flows

Item II of the old template included in the same category both future cash flows that are fixed or predetermined (such as forwards or debt service payments) and those that are contingent (such as options). *In reviewing this issue, technical experts decided to separate both categories, given their different nature. This separation is also intended to avoid adding together both types of instrument. This implies splitting item II into two separate items (contingent flows and predetermined flows, each of them including, where applicable, a breakdown between short and long positions) and* *moving to the contingent flows category some items currently included among the memo items: undrawn unconditional credit lines and foreign currency securities issued with embedded options (puttable bonds).*

II.6 Netting

In the case of derivatives, the disclosure of gross positions would provide more complete information to market participants. On the other hand, the possibility of perfectly matched positions argues in favour of netting. *The recommendation is that netting should in principle be allowed if offsetting positions are maintained with the same counterparty and at the same maturity, and insofar as there is a legally enforceable netting agreement in place allowing settlement in net terms. Netting would also be allowed for matched positions on organised exchanges.*

II.7 Securities lent and on repo and pledged assets

Securities lending,[1] repos and pledged assets have one aspect in common, namely that an asset is used to borrow funds that in turn may finance the acquisition of another asset. The issue was whether to count both the pledged asset and the accompanying liability or whether to exclude both of them to avoid double-counting. Accounting practices differ widely in this respect among countries, so that it would not be feasible to agree on a common approach while at the same time providing continuity with present practices. *The proposal is to allow both solutions – include them among the assets and the liabilities or exclude them from both sides – requiring at the same time an explicit explanation of the accounting treatment. In both cases these operations would be reported in the memo items, regardless of whether or not they are included somewhere else in the template.*

II.8 Memo items

Memo items provide complementary information on: (i) positions that are not disclosed in other categories but are deemed relevant for the markets; (ii) positions that are disclosed within a broader category (and whose separate identification provides some value added in terms of information); and (iii) positions according to a breakdown or a valuation criterion different from those used in categories I to III. Splitting the memo items between assets and liabilities would clarify the structure of the template and make it look – in terms of presentation – more like the one proposed by the IMF. However, the rearrangement of the items according to the criterion of predetermined vs. contingent flows reduced the scope of the memo items. As a consequence, the distinction between assets and liabilities would only be relevant or useful for a few of them. Therefore, in terms of presentation *it is proposed to keep only one category for memo items and to add a footnote asking for the split between assets and liabilities where applicable.*

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[1] Securities borrowing would be treated symmetrically as securities lending.

III. Options

III.1 Selective vs. comprehensive disclosure

The previous template proposed the disclosure of all the possible positions in options in notional value, but only the estimated foreign currency drain or inflow of written options and not of bought options. The technical experts reviewed this proposal and *concluded that – regardless of the decisions on valuation criteria, which are explained below – the disclosure had to be comprehensive, while attempting to avoid increasing the size of the template excessively.*

III.2 Relevant criteria for the presentation of the information

Information on options could in principle be shown along three axes: written vs. bought, calls vs. puts, long positions vs. short positions in foreign currency. The presentation of the ECSC template emphasised the distinction between written and bought options, which is basically related to the position of the central bank with respect to the execution of the contract (passive and active respectively). This was in contrast to the treatment of futures and forwards, in which case the emphasis was on short vs. long positions. *The conclusion was that the distinction between short and long positions (future outflows and inflows of foreign currency respectively) is the most relevant for items II and III of the template. Both types of operation (forwards and futures on the one hand, options on the other) should therefore be treated similarly, emphasising in the presentation the distinction between short and long positions.*

III.3 The valuation of options

In terms of valuation of options, the old template proposed the disclosure of the nominal value and – with a narrower coverage, as explained under point II.1 above - the estimated inflow or outflow. On the revision of this issue, it was confirmed that the notional value of the overall position is the relevant criterion to identify the maximum exposure resulting from the options' position. At the same time, it was acknowledged that other valuation criteria should be used to estimate the possible future inflows and outflows in foreign exchange arising from the position in options. Two possibilities were identified in this respect: the notional value of in-the-money options and the estimated market value of the overall position, according to central banks' internal models. The reliance on internal models was regarded in general as sub-optimal for this exercise. At the same time, the technical experts considered that some sensitivity analysis of the exposure (in terms of foreign exchange liquidity) arising from the position in options to different exchange rate scenarios would be useful. *Taking all this into account, the recommendation is to disclose (i) the notional value*[2] *of all the options with maturities shorter than one month, three months and one year and (ii) the notional*

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[2] The notional value may not be the most appropriate valuation criterion for options that are cash-settled (that is, those for which only the difference between the underlying price and the strike price would be paid upon exercise). In their case, the estimated inflow or outflow would be used instead.

value of the options that are in the money for each maturity category, with the following breakdown:

	1 month	**1 - 3 months**	**3 months - 1 year**
At current exchange rates			
± 5% (instantaneous change in the value of the domestic currency vis-à-vis all other currencies)			
± 10% (instantaneous change in the value of the domestic currency vis-à-vis all other currencies)			

As regards the market value of the options, it was also decided that the market value of derivatives in general would be disclosed among the memo items (under category IV-1-e: "financial derivative assets (net, marked to market)"), with the appropriate breakdown by types of instrument.

DISCLOSURE TEMPLATE

(information to be disclosed by monetary authorities and
other central government, excluding social security)[1,2,3]

I. Foreign currency reserves and other foreign currency assets including gold (approximate market value)[4]

(1) foreign currency reserves (in convertible foreign currencies)

(a) securities

of which:

issuer headquartered in the reporting country

(b) total deposits with:

(i) other central banks and the BIS

(ii) banks headquartered in the reporting country

of which:

located abroad

(iii) banks headquartered outside the reporting country

of which:

located in the reporting country

(2) IMF reserve position

(3) SDRs

(4) gold (including gold on loan) (valued according to disclosed conventions)

(5) other (specify)

II. Predetermined short-term net drains (outflows and inflows) on foreign currency reserves (residual maturity) (nominal value)

	Total	**Maturity breakdown (where applicable)**		
		Up to 1 month	**More than 1 month and up to 3 months**	**More than 3 months and up to 1 year**
1. Foreign currency loans and securities[5]				
2. Aggregate short and long positions in **forwards and futures** in foreign currencies vis-à-vis the domestic currency (including forward leg of currency swaps)				
2 a) Short positions				
2 b) Long positions				
3. Other (specify)				

III. Contingent short-term net drains (outflows and inflows) in foreign currency reserves

	Total	Maturity breakdown (where applicable)		
		Up to 1 month	More than 1 month and up to 3 months	More than 3 months and up to 1 year
1. Contingent liabilities in foreign currency				
1 a) Collateral guarantees on debt falling due within one year				
1 b) Other contingent liabilities				
2. Foreign currency securities issued with embedded options (puttable bonds)[6]				
3. Undrawn unconditional credit lines[7]				
3 a) with other central banks				
3 b) with banks and other financial institutions headquartered in the reporting country				
3 c) with banks and other financial institutions headquartered outside the reporting country				

III. Contingent short-term net drains (outflows and inflows) in foreign currency reserves (nominal value) (continued)

	Total	Maturity breakdown (where applicable)		
		Up to 1 month	More than 1 month and up to 3 months	More than 3 months and up to 1 year
4. Aggregate short and long positions of **options** in foreign currencies vis-à-vis the domestic currency				
4 a) Short position				
4 a) (i) Bought puts				
4 a) (ii) Written calls				
4 b) Long position				
4 b) (i) Bought calls				
4 b) (ii) Written puts				
PRO MEMORIA: In-the-money options[8,9]				
1) At current exchange rates				
1 a) Short position				
1 b) Long position				
2) +5%				
2 a) Short position				
2 b) Long position				
3) –5%				
3 a) Short position				
3 b) Long position				
4) +10%				
4 a) Short position				
4 b) Long position				
5) –10%				
5 a) Short position				
5 b) Long position				
6) Other (specify)				

IV. Memo items

(1) with standard frequency and disclosure lag[10]

(a) short-term domestic currency debt indexed to the exchange rate

(b) financial instruments denominated in foreign currency and settled in domestic currency[11,12]

(c) pledged assets

(d) securities lent and on repo[13,14]

(e) financial derivative assets (net, marked to market)[15,16]

(2) which can be disclosed less frequently (e.g. once a year)

(a) currency composition of reserves (by groups of currencies)

Notes:

[1] In principle, only instruments settled in foreign currency are to be included in categories I, II and III of the template. Financial instruments denominated in foreign currency and settled in domestic currency are included as memo item IV-1-b.

[2] Netting of positions is allowed only if they have the same maturity, are against the same counterparty and a master netting agreement is in force. Positions on organised exchanges could also be netted.

[3] Monetary authorities defined according to the Balance of Payments Manual # 5 of the IMF.

[4] In cases of large positions vis-à-vis institutions headquartered in the reporting country, in instruments different from deposits or securities, they should be reported in a separate item.

[5] Including interest payments due within the corresponding time horizons.

[6] Bonds disclosed under this item should not be disclosed in Section II.

[7] Where applicable, distinguish between potential inflows and potential outflows.

[8] Could be disclosed in the form of a graph.

[9] As a rule, notional value, except for cash-settled options, in which case the estimated future inflow/outflow should be disclosed.

[10] Split between assets and liabilities where applicable.

[11] Split by types of instrument.

[12] The valuation principles should be the same as in items I to III.

[13] Securities borrowed should be treated symmetrically as securities lent.

[14] Market value.

[15] Split by types of instrument.

[16] To calculate the market value, internal models are to be used, whose main characteristics should be disclosed.

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ECSC Review of Disclosure Template by Technical Experts

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