BANK FOR INTERNATIONAL SETTLEMENTS

ENHANCING TRANSPARENCY REGARDING THE AUTHORITIES' FOREIGN CURRENCY LIQUIDITY POSITION

Report of a Working Group established by the
Euro-currency Standing Committee
of the central banks of the Group of Ten countries

Basle
28th September 1998

ENHANCING TRANSPARENCY REGARDING
THE AUTHORITIES' FOREIGN CURRENCY LIQUIDITY POSITION

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Euro-currency Standing Committee

Enhancing transparency regarding the authorities' foreign currency liquidity position

Report of a Euro-currency Standing Committee working group

EXECUTIVE SUMMARY

The Asian crisis highlighted deficiencies in the availability of information relating to the on and off-balance-sheet foreign currency activities of central banks and other public sector entities. This led the G-10 Governors to ask the Euro-currency Standing Committee to establish a working group to develop a disclosure framework to address these shortcomings. Specifically, the group was asked to identify the statistical information that would enable markets to better assess the authorities' foreign currency liquidity position. This position comprises the foreign exchange resources at the disposal of the authorities that are easily mobilisable in times of need and the potential drains on those resources associated with the authorities' short-term foreign currency liabilities. The group was also asked to report on the most suitable framework for public disclosure, the specific form and content of the information to be released and the additional practical steps necessary to implement the chosen strategy. In its deliberations the group recognised that improvements in disclosure practices by G-10 countries could help to encourage similar behaviour in emerging market countries.

The analysis and recommendations of the working group should be assessed in the context of initiatives relating to disclosure currently under way in other forums. These include the work of a working party on transparency and accountability commissioned by a group of finance ministers and central bank governors from 22 economies (the "Willard Group") and planned steps by the IMF Executive Board to strengthen the Special Data Dissemination Standard (SDDS). In recognition of these initiatives, an IMF representative was invited to participate in the working group and information on disclosure practices was shared with the Willard Group working party. A representative from the European Central Bank (ECB) was also asked to participate in the group.

The working group is of the opinion that a significant move towards enhanced disclosure is justified as regards both the content and the timeliness of the information. This conclusion was reached on the basis of a review of current disclosure practices in relation to the liquidity concept outlined in previous discussions among Governors and a cost/benefit analysis of such a step. Prevailing practices generally fall well short of providing the relevant information, particularly as concerns the potential short-term

drains on reserves. As most recently highlighted by the Asian crisis, the failure to disclose the forward book of the monetary authorities is one important example. The main benefits of enhanced disclosure would be to improve the accountability of the authorities and the scope for markets to exercise financial discipline. This, in turn, could help to induce an earlier correction of unsustainable policies and allow market participants to form a more accurate view of the condition of individual countries, thereby also possibly limiting contagion. It was noted that effective market discipline mechanisms also require an appropriate framework for disclosure and reporting by private sector entities. Differing views were expressed in this regard and the group acknowledged that this issue deserved further analysis. The group weighed the possible benefits of greater transparency against some potential costs. These were seen as being primarily associated with reduced operational flexibility to intervene covertly in order to counteract exchange market pressures, with the uncertainties involved in the transition towards a more demanding disclosure standard and with the logistical burdens of implementation.

The specific recommendations of the group take the form of: a *"disclosure template"* outlining the content of the information to be disclosed; prescribed *standards of timeliness*, including both periodicity and disclosure lags; a *timetable for implementation*; and a proposal for further work on *disclosure standards for private market participants*.

The disclosure template, summarised below, has three distinguishing features. Firstly, it aims to be as *comprehensive* as possible with respect to the coverage of both institutions and financial instruments. As regards institutions, conceptually the template is intended to apply to all the 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. As regards financial instruments, the template attempts to cover all the relevant on and off-balance-sheet liquid assets and short-term liabilities. Comprehensiveness is designed to provide a meaningful picture and to limit the scope for shifting components of the liquidity position to undisclosed items. Secondly, the template seeks to be sufficiently *detailed* to allow market participants to reach informed judgements about both reserves and drains on them. Detail is provided in several respects. These include, inter alia: a sectoral breakdown (notably as between the monetary authorities and other public sector entities); the separate identification of financial instruments that might vary in terms of liquidity (e.g., gold, deposits with banks headquartered in the reporting country) or cash flow characteristics (e.g., contingent vs. predetermined; time profiles, as captured by a residual maturity breakdown of the fixed-term liabilities); and complementary memorandum items (e.g., undrawn unconditional lines of credit, debt indexed to foreign currency). Finally, the template prescribes *valuation principles that are consistent with the focus on liquidity*. This suggests reporting, as far as possible, mobilisable foreign exchange resources at (approximate) market values and the future profile of drains on these resources in nominal terms (the cash flow value when the drain occurs).

The group recommends endorsement of the template. At the same time, it recognises that improvements are possible. A review by technical experts of the details of the presentation would be helpful in identifying improvements in the way some of the information is portrayed and in accomplishing effective implementation. The issues to be addressed include, in particular, the treatment of derivatives positions and the clarification of the relationship between the definitions used in the report and those adopted in the balance-of-payments conventions, which are largely based on the residence criterion. It is recommended that technical experts be asked to report on these issues as soon as possible.

The working group devoted much attention to the issue of timeliness, particularly in the light of the substantial element of judgement called for in examining this question. There are two features of information disclosure that affect timeliness: the disclosure lag, which determines how out-of-date the information is *when released*; and the frequency or periodicity of the disclosure, which determines the extent to which the information ages *between releases* and affects the incremental "news" content of the release. The group agreed that a *common* frequency and disclosure lag should apply to all the items of the template (except one memorandum item, viz. the currency composition by group of currencies). To do otherwise could greatly undermine the template's usefulness as it would provide an avenue for concealing changes in liquidity through whatever items are reported in the least timely fashion. The group also agreed that it is technically feasible to set a very high frequency and short lag. At the same time, the concomitant gains in terms of market discipline had to be weighed against the possible need for flexibility in exchange market operations, either for reserve management purposes or for covert intervention. In order to preserve flexibility in reserve management, the group decided to allow for less frequent and less detailed disclosure of the currency composition of the portfolio. Furthermore, forward positions should be reported only insofar as the domestic currency is involved, since only those transactions imply a future change in total official reserves. As concerns covert intervention, views regarding the true extent and value of such flexibility varied somewhat within the group. This reflected several factors, notably differing experiences with exchange rate regimes, institutional settings and opinions about the range and likelihood of circumstances in which it was regarded as useful to retain market uncertainty about the occurrence and/or size of the authorities' operations. Two further considerations argued against a rapid move to the highest feasible frequency and shortest feasible lag: implementation costs (especially in the context of efforts to address the "Year 2000 problem" and the introduction of the euro); and, given the residual uncertainties involved, concerns that such a step, once taken, would be costly to reverse if it proved unwarranted.

In the light of these concerns, the group recommends that a first step would be to adopt a standard of a one-month frequency and a disclosure lag certainly not exceeding one month, to be implemented on or before end-June 1999. Since the frequency and disclosure lag would apply to all the categories of the template – except one memorandum item – this would already represent a significant improvement compared with current practices. In addition, the group notes that central banks are not the only holders of foreign currency reserves or liabilities, so that the full implementation of its

recommendations would also require endorsement and corresponding action by other public sector entities, in particular finance ministries or treasuries.

The group also considered the benefits associated with similar transparency about the risk positions, including foreign currency positions, of all private financial intermediaries. The group was of the opinion that further parallel work is needed in this area. It noted that an initial analysis had been carried out by the Euro-currency Standing Committee in 1994, as published in the report on “public disclosure of market and credit risks by financial intermediaries” (the “Fisher Report”). In connection with the enhanced disclosure proposed for the official sector, the group recommends that the ECSC now revisit the question of the appropriate disclosure standards for all market participants with a view to elaborating a set of good practices.

SUMMARY DISCLOSURE TEMPLATE

(information to be disclosed separately by central banks, other monetary authorities and relevant public sector entities)

Foreign currency reserves and other foreign currency assets including gold (approximate market value)

1) foreign currency reserves
2) IMF reserve positions
3) SDRs
4) gold (valued according to disclosed conventions)
5) other (specify)

Short-term drains on foreign currency reserves (nominal value)

1) foreign currency short term loans and securities (breakdown by residual maturity)
2) contingent liabilities
3) aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including forward leg of currency swaps) (breakdown by residual maturity)
4) aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency (notional amounts and estimated net drain calculated using internal models)

Memo items

1) with standard frequency and disclosure lag
   (a) undrawn unconditional credit lines (breakdown by type of counterparty)
   (b) foreign currency securities issued with callable features (puttable bonds)
   (c) domestic currency debt indexed to the exchange rate
   (d) pledged assets
   (e) securities lent and on repo
2) which can be disclosed less frequently (e.g., once a year)
   (a) currency composition of reserves (by groups of currencies)

Bank for International Settlements 28th September 1998

Euro-currency Standing Committee

Enhancing transparency regarding the authorities' foreign currency liquidity position

Report of a Euro-currency Standing Committee working group

Introduction

The Asian crisis has highlighted deficiencies in the availability and public disclosure of information relating to the on and off-balance-sheet foreign currency activities of public and private sector institutions alike. Such shortcomings arguably helped exacerbate the financial turmoil by obscuring the build-up of financial weaknesses and imbalances and by complicating crisis management. One area where timely and accurate information is thought to have been lacking is the disclosure of the authorities' foreign currency reserves and short-term liabilities. Against this background, the G-10 Governors asked the Euro-currency Standing Committee to establish a working group to report on the most suitable framework for public disclosure, the specific form and content of the information to be released, and the additional practical steps necessary to implement the chosen strategy. In its deliberations the group recognised that improvements in disclosure practices by G-10 countries could help to encourage similar behaviour in emerging market countries.

The working group concluded that a significant move towards enhanced disclosure was justified as regards both the content and the timeliness of the information. This conclusion was reached on the basis of a review of current disclosure practices and a cost/benefit analysis of such a step. In this analysis, the benefits of enhanced disclosure, primarily in the form of improved accountability of the authorities and the possibility of greater market discipline, were weighed against its potential costs, mainly associated with a possible reduction in operational flexibility in foreign exchange markets, with the uncertainties involved in the transition towards a more demanding disclosure standard, and with the logistical burdens of implementation. The specific recommendations of the group take the form of: a *disclosure template* outlining the content of the information to be disclosed; prescribed *standards of timeliness*, including both periodicity and disclosure lags; a *timetable for implementation*; and a proposal for further work on *disclosure standards for private market participants*.

The analysis and recommendations of the working group should be assessed in the context of initiatives relating to disclosure currently under way in other forums. These include the work of a working party on transparency and accountability commissioned by the group of finance ministers and central bank governors from 22 economies (the "Willard Group") and planned steps by the Executive Board of the International Monetary Fund (IMF) to strengthen the Special Data Dissemination

Standard (SDDS). In recognition of these initiatives, an IMF representative was invited to participate in the working group and information on disclosure practices was shared with the Willard Group working party. A representative from the European Central Bank (ECB) was also asked to participate in the group.

The next section introduces the concept of the liquidity position of the public sector, which underlies the key recommendations of the working group, and reviews current disclosure practices. Section II reviews benefits and costs of enhanced disclosure in the light of this concept. Section III describes the specific recommendations developed by the working group and the motivations behind them. A brief summary of the principal recommendations concludes.

I Object of the analysis and current practices

The authorities' liquidity position

The main focus of the report is on the foreign currency *liquidity position* of the authorities. This in turn comprises two elements:

- the foreign currency *resources at the disposal* of the authorities to meet a sudden increase in the demand for foreign exchange ("reserves");
- the *potential (net) drains* on those resources originating from the authorities' short-term liabilities in foreign currency ("reserve-related drains").

The report's focus raises at least three issues: the specific sectoral coverage; the implications of the distinction between the currency of denomination (including indexation clauses) and the settlement medium of contracts; and the relevance of the distinction between residents and non-residents. Each of these issues is considered in turn.

For the purposes of the present analysis, the term "authorities" should be taken to refer, conceptually, to all the 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). However, depending on institutional arrangements it could extend to other public sector entities, such as state-owned commercial banks actively employed to offset foreign currency drains.

It is clear that, so defined, the authorities' liquidity position is only one piece of information, albeit a crucial one, for assessing the foreign currency *liquidity risk* facing a country: the risk that in a crisis, depending on the exchange rate regime, the available foreign currency liquid resources might be insufficient to meet increases in demand for foreign currency. A fuller assessment of this risk requires broader information on the liquidity position of both the public and private sectors. Since, in addition to holding reserves, central governments typically account for a large fraction of the public sector's foreign currency liabilities, their inclusion in the institutional coverage should help to

capture a major source of drains on reserves. At the same time, drains could obviously also arise from other parts of the public sector. Moreover, the line between public and private sector debt can be a fine one indeed, as highlighted by the socialisation of risks in the recent Asian crisis. The report's primary focus on explicit central government liabilities should be seen as reflecting mainly concerns with the practical implementation of its recommendations.

Drains on reserves can of course arise equally from the redemption of liabilities to be settled in foreign currency or from the conversion of contracts denominated in domestic currency (upon liquidation or redemption). The present report focuses on those associated with foreign currency liabilities because the potential size of the drains connected with domestic currency instruments is very difficult to quantify. Domestic currency liabilities of the authorities should therefore rather be considered a potential source of exchange market pressure, like any other possible component of excess demand for foreign exchange. At the same time, instruments settled in domestic currency but indexed to foreign currency merit a special mention. Strictly speaking, just as in the case of conventional domestic-currency-denominated debt, the redemption of such indexed liabilities does not have a direct impact on the level of reserves. Nonetheless, recent experience tends to indicate that indexed liabilities can represent a major source of indirect pressure on reserves during a crisis, particularly when a sharp depreciation leads to a major increase in the value of indexed liabilities which are then exchanged into foreign currency by their holders. Similar considerations arguably apply to the use of futures or non-deliverable forwards as substitutes for intervention through traditional forwards and to the issuance of instruments with a foreign exchange guarantee. Ultimately, where the line is best drawn depends to a considerable extent on practical considerations, such as how extensive the use of a particular instrument is.

The key issue under examination is the ability of the authorities to deal with foreign currency drains, regardless of whether the demand for foreign exchange arises from residents or non-residents. Admittedly, this distinction could be relevant in some circumstances. One reason is that during a crisis the authorities may resort to measures that have a territorial jurisdiction, such as capital controls. Another, arguably more speculative, reason is that systematic differences might exist in the tendency for residents and non-residents to demand foreign exchange as strains emerge. Neither of these considerations, however, would seem to justify making an explicit distinction between the two types of holder in the disclosure framework. Moreover, on practical grounds, information on the identity of holders is difficult to obtain: at a minimum, its inclusion in any disclosure standard would impair the timeliness of disclosure. The decision to downplay the resident/non-resident distinction raises the need to clarify the relationship between the concepts developed in this report and current balance-of-payments practices, in which residence plays a crucial role. In order to ensure an effective implementation of the proposals made in this report, it is recommended that a panel of experts address the issue of how to reconcile the proposed disclosure standards with conventional balance-of-payments practices.

Current disclosure practices

A review of the current disclosure practices of the countries participating in the working group (Annex II) and experience with recent financial crises in emerging

markets strongly suggest that the information supplied to the public falls well short of providing an accurate, let alone timely, picture of the authorities' liquidity position. Some deficiencies can be identified with respect to the disclosure of liquid resources. However, the main shortcomings relate to the disclosure of potential drains associated with foreign currency liabilities and derivative instruments.

As regards reserves, several aspects can be highlighted. Some questions arise about the treatment of pledged assets which, while frequently not available for use, can be included in reserves – according to balance–of-payments statistical conventions – without separate identification. Although, in accounting terms, pledging an asset to raise funds can increase the total size of the balance sheet, for the purpose of liquidity it is important to avoid double-counting. Similarly, the recent Asian experience shows how failure to indicate the part of reserves held with financially weak domestic banks (in this case their foreign affiliates) can lead to a de facto overestimate of the authorities' liquidity position. In addition, valuation practices can depart significantly from the use of approximate market values. This complicates the assessment of the realisable value of reserves. Finally, publicly available information generally fails to cover unused unconditional lines of credit. Admittedly, the effectiveness of these arrangements still needs to be fully tested. Nevertheless, provided they are properly designed, they could represent a complementary source of foreign exchange at times of need, even though, depending on the maturity, they could generate a corresponding short-term liability.

With respect to potential drains on resources, an important omission is the general lack of public information about off-balance-sheet positions, which is disclosed by only a few countries in the group. As highlighted by the recent financial crisis in Asia, for instance, not disclosing forward commitments can substantially overstate the amount of unencumbered reserves. Moreover, even in those cases in which information about these positions is publicly available, it is usually far less timely than corresponding data on (on-balance-sheet) reserves. Similarly, experience indicates that information on central government foreign currency liabilities is often inadequate.

II Benefits and costs of disclosure

This preliminary analysis indicates that substantial scope for enhancing disclosure exists. However, how far and how speedily disclosure should be enhanced will depend on a judgement about the balance between the benefits and costs involved.

The potential *benefits* of enhanced disclosure include:

(i) *strengthening the accountability of the authorities* by providing the public with more information regarding their policy actions and choices;

(ii) *facilitating the efficient functioning of markets* in several respects. Improved information, by limiting uncertainty, should remove a source of financial volatility and increase the scope for effective market discipline. In turn, by helping to counteract any tendency of the authorities to delay policy adjustments, this should encourage an earlier correction of unsustainable policies and external positions. In addition, by allowing market participants to form a more accurate view of the condition of individual countries, it could contribute to reducing erratic movements in capital flows associated with uncertainty and "surprises" and to limiting contagion to other countries;

(iii) *increasing the accountability of private sector creditors* for any losses that they might incur in their investment or lending decisions and which could otherwise be blamed on the authorities' withholding of information necessary for judging the financial condition of a country. This in turn could facilitate efforts to secure a more balanced burden sharing between the public and private sector in the resolution of crises;

(iv) *underpinning efforts to strengthen transparency standards in the private sector*, by having the public sector lead by force of example.

On the other hand, the potential *costs* include:

(i) *less flexibility in exchange market operations*. This could relate to reserve management or to covert intervention operations. In particular, less flexibility in covert intervention, in terms of either its occurrence or its size, could reduce the authorities' ability to counteract temporary exchange market pressures which, in retrospect, could prove not to have been justified by economic fundamentals;

(ii) *implementation costs,* broadly defined to include the resource costs incurred in producing the relevant information (e.g., technical systems) and in ensuring its quality (perhaps to auditable standards) and disseminating it;

(iii) *costs associated with irreversibilities in the steps taken*. These relate to the concern that, given the uncertainties involved in reaching a final judgement, a step to improve transparency which in retrospect proved to

be inappropriate could be difficult to reverse. Such a reversal could be seen as a negative signal regarding the authorities' commitment to transparency as a broader principle. This in turn could undermine efforts to enhance transparency more generally and generate uncertainty among market participants.

Overall, the group was of the opinion that the balance between benefits and costs was such as to justify a significant move in the direction of greater transparency. Indeed, with the liberalisation of financial markets, a broad shift in this direction has been taking place in a wide range of areas, from prudential supervision to monetary policy. This has largely reflected attempts to provide markets with the necessary raw material (information) to operate efficiently. In general, the group held the view that better informed markets can provide more accurate signals to policy-makers. Nevertheless, it was mentioned by some members that a substantial move towards disclosure should be accompanied by an analysis of the disclosure requirements to be applied to market operators.

The group was also of the view that there was substantial scope for improving the trade-off between benefits and costs by judicious action in three areas: the *content* of the information to be disclosed; the *standard of timeliness* of the corresponding disclosure; and the *timetable for the implementation* of the framework. There was a consensus that the information should correspond as closely as possible to the concepts relevant for the assessment of liquidity positions, as discussed above, and that the main room for manoeuvre largely concerns timeliness and the implementation process.

III Features of an effective disclosure framework

An analysis of the desirable features of an effective disclosure framework can be usefully divided into two parts: an examination of the *"disclosure template"*, which outlines the content of the information to be disclosed; and consideration of the corresponding *standards of timeliness*, including both periodicity and disclosure lags.

The disclosure template

The disclosure template can be judged by whether it provides financial markets with the information they need to assess accurately foreign currency resources and the potential short-term drains on them. For this to be the case, the template should have at least three characteristics. Firstly, it should be *comprehensive* with respect to the coverage of both institutions and financial instruments. Comprehensiveness is intended to provide a meaningful picture of the authorities' liquidity position, to minimise the risk of unexpected drains causing sharp falls in the measure of reserves and to limit the scope for distortions in the information supplied, as could occur by shifting intervention activity to undisclosed items or non-reporting entities. Secondly, the template should be *sufficiently detailed* to allow market participants to reach informed judgements. Thirdly, the template should prescribe *valuation principles that are consistent with the focus on liquidity*.

The proposed template, shown in Annex I, is a first attempt to incorporate these considerations.

As regards institutional *comprehensiveness*, the definition of "authorities" is the broad one put forward in Section I of the report. With respect to financial instruments, the template attempts to include all relevant categories of on and off-balance-sheet liquid resources and potential short-term drains on them. As regards off-balance-sheet positions, disclosure is only relevant when they affect the size rather than the composition of reserves and potential drains on them. Therefore, only off-balance-sheet positions in instruments vis-à-vis the domestic currency have to be disclosed. Financial contracts with contingent characteristics, both as possible reserves and as drains on them, are explicitly included; unused unconditional lines of credit and contingent liabilities are notable examples. A question arises concerning the cut-off *residual* maturity that defines "short-term". Conceptually, by analogy with the practice for value-at-risk models, the length of the horizon could be chosen so as to reflect the lag with which the authorities could typically be expected to react to signs of strain by making credible fundamental adjustments in their economic policies and re-establishing unhindered access to external finance. In practice, given the difficulties in identifying this horizon – which could vary with circumstances – it would seem reasonable to maintain the traditional cut-off (up to one year), which in general is sufficient for credible policy changes by the authorities, while at the same time showing a finer maturity breakdown. The group proposes up to one month, between one and three months and between three months and one year.

The template provides *detail* in several respects.

Firstly, a sectoral breakdown is given where institutional factors warrant it. This applies to the distinction between the central bank, the central government and, where applicable, other public sector entities.

Secondly, the template identifies separately those financial instruments that might differ in terms of liquidity or cash flow characteristics. As regards liquidity, for instance, gold, securities and various types of deposits are distinguished. As regards drains, a clear distinction is made between those of predetermined size (e.g. a forward position) and those with contingent cash flow features (e.g. associated with options or contingent liabilities). Similarly, inflows and outflows are shown separately in order to allow for the possibility that in some circumstances the inflows associated with commitments to receive foreign currency at a given future date may be less than fully certain, for example for reasons relating to the credit quality of the counterparties. The maturity breakdown provides further information on the structure of inflows and outflows in the near term.

Thirdly, complementary relevant information is presented in the form of memorandum items. For instance, undrawn unconditional lines of credit identify a possible complementary source of liquid resources and, to the extent that they have to be repaid in the short term, corresponding subsequent drains. Debt indexed to foreign currency can give an indication of a potentially important source of indirect pressure on reserves. The breakdown of foreign exchange reserves by groups of currencies can help outside observers better to interpret their liquidity. The group recognised that a finer breakdown by individual currencies could help market participants to assess the reasons

behind changes in the overall liquidity position over time. Indeed, the authorities could possibly go one step further and provide at some appropriate interval a breakdown of the change in the position that results from valuation changes, income flows, transactions and possibly changes in the perceived liquidity of certain items. However, because of some concerns with the implications for portfolio management and foreign exchange dealings, the group decided not to include these two breakdowns in the template.

Valuation principles present some of the most difficult issues. In general, *resources* should be valued in a way that would reflect what could be obtained for them in the market when liquidated, which suggests valuing them at (approximate) market value. The various current practices used to value gold could continue to be used as long as the valuation conventions are disclosed. To the extent that strict marking to market is considered not to be practical or, in some cases, not appropriate for other assets, these should at least be valued at current exchange rates and the corresponding valuation principles disclosed. Valuing assets at current exchange rates would deal with the major part of the potential inaccuracies. *Drains on resources*, by contrast, are best valued in nominal terms, i.e. at the value of the cash flow when the drain occurs. The valuation of contingent cash flows, such as those associated with options, is far from straightforward. At a minimum, the nominal value of outstanding contracts should be shown, so as to capture the scale of exposure in the event of extreme market movements. In addition, the authorities could use their internal models to estimate the expected drain, defined as the probability that the option will be exercised, multiplied by the nominal value of the contract. In this case, an explanation of the estimation method should also be presented. More generally, the working group felt that the best way of applying the recommended principles of valuation for liquid resources and drains deserves further consideration by technical experts, particularly in respect of derivative instruments.

The group also considered the merits of recommending that positions be reported on a transaction-date rather than settlement-date basis, as is currently the case. Since the difference between both is small for spot transactions, the most significant effect of such a change would be the automatic disclosure of very short-dated forward transactions. As the group’s recommendation to disclose forward positions makes this distinction largely immaterial, there is little need to alter current practices.

Timeliness

The choice of appropriate standards of timeliness for disclosure is difficult, and ultimately can only be a matter of informed judgement rather than precise calculation. The recognition that information has to be comprehensive in order to be useful implies that differences in judgement regarding the costs and benefits of enhanced disclosure will be mainly reflected in differences of views regarding the timeliness standard.

There are two features of disclosure that affect timeliness: the *disclosure lag* and the *frequency or periodicity of the disclosure*. The disclosure lag determines how out-of-date the information is *when released.* The frequency determines the extent to which the information ages *between releases* and affects the incremental "news" content of the release. The sum of the lag and frequency define the maximum age of the information available to market participants.

In reaching a view regarding an appropriate standard for timeliness, the group took a number of propositions as starting points. Firstly, the benefits of disclosure tend to increase with the timeliness of the information. In general, greater frequency of disclosure makes for a smoother flow of information and for more effective monitoring. Recent experience with financial crisis shows just how fast conditions can change, underscoring the value of short disclosure lags. At the same time, it was noted that some questions remain in cases of very high frequency and very short lags, especially when the disclosure by market participants is insufficient. Secondly, it is desirable that a common frequency and lag apply to all the main items of the template. To do otherwise could greatly undermine its usefulness as it would provide an avenue for concealing changes in the liquidity position through whatever items are reported in the least timely fashion. While acknowledging that where to draw the line is somewhat arbitrary, the group proposes that only the currency composition by group of currencies be subject to less stringent standards of timeliness. Finally, there do not appear to be significant technical impediments to setting a very high frequency and a short disclosure lag.

These propositions combined suggest that the key factor in choosing an appropriate standard for timeliness is the judgement about the costs involved. Among these, the most difficult to quantify relate to the potential loss of flexibility in *covert interventions*. Views regarding the true extent and significance of these costs varied within the group. This reflected several factors, notably differing experiences with exchange rate regimes, institutional settings and opinions about the range and likelihood of circumstances in which it might be useful to retain uncertainty regarding the occurrence and/or size of the authorities' operations. There was a consensus, however, that flexibility in terms of the size of the operations was more valuable than with respect to their occurrence. Another possible source of costs arises from the constraints on *reserve management* that may result from an excessively detailed disclosure. In order to minimise these costs, it seems desirable to allow for less frequent and less detailed disclosure of the currency composition of the portfolio.

As regards implementation costs, a distinction should be made between those that are incurred once, with the introduction of a new system, and those of running the systems once in place. In general, the one-time up-front costs, arguably the more

significant ones, should have a stronger influence on decisions regarding the timing and pace of implementation than on longer-run desirable standards. Another concern relating to the timetable for implementation is the "irreversibility" of disclosure policies noted above. Costs associated with the uncertainty about the final judgement reached would therefore suggest incremental improvements in timeliness. This would enable experience to be gained with less ambitious standards before taking decisions about successive stages. Those countries willing to proceed faster should be encouraged to do so. The specific recommendations listed in the following section reflect these considerations.

IV Recommendations

To summarise, the working group is of the opinion that a significant move towards enhanced disclosure is justified as regards both the content and the timeliness of the information. The specific recommendations of the group take the form of:

- the *disclosure template* outlined above, identifying the content of the information to be disclosed;
- prescribed *standards of timeliness*, including both periodicity and disclosure lags;
- a *timetable for implementation*;
- a proposal for further work on *disclosure standards for private market participants.*

Regarding the *template*, the group was of the opinion that disclosure of the categories outlined above would go a long way towards improving the transparency and accountability of the authorities. While the template accurately reflects the principles underlying the group's views of the elements needed to determine the public sector's liquidity position, some specific presentational issues are still outstanding. These include, inter alia, 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. The group recommends that technical experts be asked to review these questions as soon as possible so as to ensure a speedy and smooth implementation of the template.

Regarding *implementation,* the group noted that central banks are not the only holders of reserves or liabilities, so that the full implementation of its recommendations would also require endorsement and corresponding action by other public sector entities, particularly by finance ministries or treasuries. It was further noted that the information-system functions of many monetary authorities are at the moment burdened by other major tasks, particularly the introduction of the euro and the "Year 2000 problem". A final concern was the costs of reversing any enhancements that are made.

In the light of these concerns, as regards *standards of timeliness,* the group recommends that a first step would be to adopt a standard of a one-month frequency and a disclosure lag certainly not exceeding one month, to be implemented on or before end-June 1999. Since the frequency and disclosure lag would apply to all the categories of the template – except one memorandum item – this would already represent a significant improvement compared with current practices.

The group also considered the benefits associated with similar transparency about the risk positions, including foreign currency positions, of all private financial intermediaries. The group was of the opinion that further parallel work is needed in this area. It noted that an initial analysis had been carried out by the Euro-currency Standing Committee in 1994, as published in the report on "public disclosure of market and credit risks by financial intermediaries" (the "Fisher Report"). In connection with the enhanced disclosure proposed for the official sector, the group recommends that the ECSC now revisit the question of the appropriate *disclosure standards for all market participants* with a view to elaborating a set of good practices.

DISCLOSURE TEMPLATE

(information to be disclosed separately by central banks, other monetary authorities and relevant public sector entities)

I Foreign currency reserves and other foreign currency assets including gold (approximate market value)

(1) foreign currency reserves (in convertible foreign currencies excluding pledged assets)

(a) securities

(b) total deposits with:

(i) other central banks and the BIS

(ii) banks headquartered in the reporting country *of which*:

1. demand deposits

2. time deposits

of which:

located abroad.

(iii) banks headquartered outside the reporting country *of which*:

1. demand deposits

2. time deposits

(2) IMF reserve position

(3) SDRs

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

(5) other (specify)

II Short-term drains on foreign currency reserves (nominal value)

(1) foreign currency loans and securities by residual maturity:

(a) maturing within 1-month

(b) maturing between 1-month and 3-months

(c) maturing between 3-months and 1-year

(2) contingent liabilities in foreign currency:

(a) credit lines to banks or other financial institutions headquartered in the reporting country

(b) other contingent liabilities (including contractual guarantees)

(3) aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including forward leg of currency swaps) by residual maturity:

(a) nominal value of short positions *of which;*

(i) maturing within 1-month

(ii) maturing between 1-month and 3-months

(iii) maturing between 3-months and 1-year

(b) nominal value of long positions *of which;*

(i) maturing within 1-month

(ii) maturing between 1-month and 3-months

(iii) maturing between 3-months and 1-year

(4) aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency:

(a) notional value of option position

(i) foreign currency options written against domestic currency

1. puts

2. calls

(ii) foreign currency options bought against domestic currency

1. puts

2. calls

(b) estimated foreign currency drain or inflow calculated using the authorities' internal model

(i) put options written against domestic currency

(ii) call options written against domestic currency

III Memo items

(1) with standard frequency and disclosure lag

(a) undrawn unconditional credit lines

(i) with other central banks

(ii) with banks and other financial institutions headquartered in the reporting country

(iii) with banks and other financial institutions headquartered outside the reporting country

(b) foreign currency securities issued with callable features (puttable bonds)

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

(d) pledged assets

(i) included in the definition of reserves

(ii) not included in the definition of reserves

(e) securities lent and on repo

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

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

DISCLOSURE PRACTICES BY HOLDERS OF OFFICAL RESERVES IN THE G-10 COUNTRIES[1]

	Belgium	Canada	France	Germany	Italy	Japan
I Foreign-currency reserves including gold						
(1) non-gold reserves assets						
(a) securities (including securities lent and on repo)	in total (FX)	√	in total	in total (FX)	√ (excluding FX repos)	in total
(b) deposits						
(i) at other central banks and the BIS	√	√	in total	in total (FX)	in total convertible currencies	in total
(ii) with banks head-quartered in the reporting country	in total (FX)	in total (deposits)	in total (deposits)	n.a.	in total convertible currencies	in total
(iii) with banks headquartered outside the reporting county	in total (FX)	in total (deposits)	in total (deposits)	in total (FX)	in total convertible currencies	in total
(2) IMF reserve position	√	in total	√	√	√	√
(3) SDRs	√			√	√	√
(4) gold (including gold on loan)	√	√	√	√	√	√
(5) unconditional credit lines		*		n.a.		in total
memo items:						
1) standard frequency of disclosure	weekly	monthly	weekly	weekly	monthly	monthly
2) standard disclosure lag	2 days	3 business days	1 week	2 business days	1 month	1 day (end-of-month total)
3) portion of total reserve assets held by the central bank	100%	small	almost 100%	100%	100% (including UIC)	

*≡ Reported in Annual Report.

[1] Note “In total” indicates that an item is not separately identified but is included in an aggregate that is disclosed.
A check indicates that an item is disclosed, a blank indicates that an item is not disclosed, N.A. indicates that an item is not used or held by the central bank.

	Belgium	Canada	France	Germany	Italy	Japan
4) standard method of valuation	market values	lower of market value and amortized cost	market value	lower of market value and cost [1]	market value	securities: historic cost conversion into dollars: market rate
a) assets for which method is different		gold gold loans	gold			Gold
i) alternative method of valuation		35 SDRs per ounce gold loans in fine ounces & market value	average over 3-months			35 SDRs per ounce
5) standard frequency of revaluation	yearly	monthly	every 6-months	yearly [2]	monthly (quarterly for gold)	Securities: n.a. conversion into dollars: monthly
II Short-term drains on foreign-currency reserves	only for the central bank					
(1) foreign-currency loans and securities	√	**	√	in total (with DM liabilities)	√	
(a) maturity breakdown						
(2) Contingent foreign currency liabilities: *of* which						
(a) credit lines to domestic banks	n.a.	n.a.	n.a.	n.a.	n.a.	
(b) other contingent liabilities	n.a.	n.a.		n.a.	n.a.	
(3) forwards and swaps						
(a) forward position	*					
maturity breakdown						
(b) net swaps position	*					
maturity breakdown						
(4) option position	n.a.	*	n.a.	n.a.		

[1] Change to mark-to-market or approximation with start of EMU.

[2] Change to quarterly revaluation with start of EMU.

* Reported annually.

** Partial data monthly, complete data annually.

	Belgium	Canada	France	Germany	Italy	Japan
memo items for foreign-currency loans and securities						
1) standard frequency of disclosure	weekly	monthly	weekly	monthly	monthly	n.a.
2) standard disclosure lag (in months or weeks)	2 days	3 business days	1 week	1 month	1 month (*)	n.a.
3) standard method of valuation	market values	lower of market value and amortized cost	market value	lower of market value and cost[1)]	market value	n.a.
memo items for derivative positions						
1) standard frequency of disclosure	yearly	annual				n.a.
2) standard disclosure lag (in months or weeks)		4-5 months				n.a.
3) standard method of valuation				lower of market value and cost[1)]		n.a.

(*) for "other liabilities" only

1) change to mark-to-market or approximation with start of EMU.

DISCLOSURE PRACTICES BY HOLDERS OF OFFICAL RESERVES IN THE G-10 COUNTRIES [1]

	Luxembourg	Netherlands	Sweden	Switzerland	United Kingdom[2]	United States
I Foreign-currency reserves including gold						
(1) non-gold reserves assets						
(a) securities (including securities lent and on repo)	n.a.	in total (securities and deposits)	√	in total (a + b)	√	in total
(b) deposits	√	in total			√	
(i) at other central banks and the BIS	in total	in total	√	in total (a + b)	√	in total
(ii) with banks head-quartered in the reporting country	in total (deposits)	in total	in total (deposits)	in total (a + b)	in total (deposits)	n.a.
(iii) with banks headquartered outside the reporting county	in total (deposits)	in total	in total (deposits)	in total (a + b)	in total (deposits)	n.a.
(2) IMF reserve position	√	√	in total	√	√	√
(3) SDRs		√				√
(4) Gold (including gold on loan)	√	√	√	√	√	√
(5) unconditional credit lines	n.a.					n.a.
memo items:						
1) standard frequency of disclosure	monthly/yearly	weekly	weekly	3-times a month	monthly	monthly
2) standard disclosure lag	2/6-months	1 day	1 day	1 day	2 days	1 week
3) portion of total reserve assets held by the central bank	100%	100%	100%	100%	close to 0%	25%

[1] Note “In total” indicates that an item is not separately identified but is included in an aggregate that is disclosed.
A check indicates that an item is disclosed, a blank indicates that an item is not disclosed, N.A. indicates that an item is not used or held by the central bank.

[2] All entries for the United Kingdom refer to disclosure of HM Treasury reserves and liabilities, because it is HM Treasury rather than the Bank of England which holds the reserves.

	Luxembourg	Netherlands	Sweden	Switzerland	United Kingdom	United States
4) standard method of valuation	market value	market value (fx)	mark-to-market	market value	historic cost	market value
a) assets for which method is different	fx	gold	gold	- gold - FX repos + deposits	gold	gold
i) alternative method of valuation	lower cost or market	lowest of 3 years annual average minus 30%	$42.22 per ounce USD/SEK 4.56	- gold: CHF 4595,74 per kg - FX repos + deposits: nominal value	75% of end-previous year	$42.22 per ounce
5) standard frequency of revaluation	quarterly	gold → every 3 years fx reserves → weekly	daily	quarterly	annual (exchange rates)	monthly
II Short-term drains on foreign-currency reserves						
(1) foreign-currency loans and securities	n.a.	√	n.a.	n.a.	√	n.a.
a) maturity breakdown	n.a.		n.a.	n.a.	√	n.a.
(2) Contingent foreign-currency liabilities: *of* which	n.a.			n.a.		
(a) credit lines to domestic banks	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
(b) other contingent liabilities	n.a.		n.a.	n.a.	n.a.	n.a.
(3) forwards and swaps		√			√	
(a) forward position	n.a.	in total (forwards and swaps)	√		in total (forwards and swaps)	n.a.
maturity breakdown	n.a.					n.a.
(b) net swaps position	n.a.	in total		√	in total (forwards and swaps)	n.a.
maturity breakdown	n.a.					n.a.
(4) option position	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

	Luxembourg	Netherlands	Sweden	Switzerland	United Kingdom	United States
memo items for foreign-currency loans and securities						
1) standard frequency of disclosure	monthl/yearly	weekly	weekly		monthly	
2) standard disclosure lag (in months or weeks)	2/6-months	1 day	1 day		2 days	
3) standard method of valuation	market value	market value	mark-to-market		historic cost	
memo items for derivative positions						
1) standard frequency of disclosure		yearly		monthly	quarterly	
2) standard disclosure lag (in months or weeks)	n.a.	4 months	3 months	1 month	2 months	
3) standard method of valuation	n.a.	market value	mark-to-market	market value	historic cost	

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