

Repurchase agreements, securities lending, gold swaps and gold loans: An update

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(For information)

This paper is for the information of the members of the Advisory Expert Group (AEG), regarding the currently accepted treatment of repurchase agreements, securities lending without cash collateral¹, gold loans, and gold swaps². The paper also sets out areas where work is continuing by the IMF Committee on Balance of Payments (Committee) and on which the Committee will provide further reports in due course.

Repurchase agreements and securities lending without cash collateral

Background

A securities *repurchase agreement (repo)* is an arrangement involving the sale of securities at a specified price with a commitment to repurchase the same or similar securities at a fixed price on a specified future date. Margin payments may also be made³. A repo viewed from the point of view of the cash provider is called a *reverse repo*. When the funds are repaid (along with an interest payment) the securities are returned to the “cash taker”⁴. The

¹ The term *securities (or stock or bond) lending* is sometimes used to describe both types of reverse transactions described in this note. In order to distinguish between those used involving the exchange of cash and those that do not involve the exchange of cash, this note uses the term “repurchase agreements” for those involving cash and “securities lending without cash collateral” for those not involving the exchange of cash.

² A fuller description of repurchase agreements, securities lending, gold loans and gold swaps can be found at <http://www.imf.org/external/pubs/ft/bop/2001/01-16.pdf>

³ “Margin” represents the value of the securities delivered that is in excess of the cash provided. Margin payments may be made at the initiation of the repo or during its life (should the market value of the securities provided fall below a threshold).

⁴ Terms such as “borrower”, “lender”, “purchaser” or “seller” may be misleading in this context, given the nature of these transactions. Accordingly, this paper uses the more neutral terms of “cash provider” and “cash taker” in discussing repos, in line with those used by Simon Grey (1998) *Repo of Government Securities*.

provision of the funds earns the cash provider interest that is related to the current interbank rate (determined at the outset of the transaction) and not the rate of interest earned on the security “repoed.” Full, unfettered ownership passes to the “cash provider” but the market risk — the benefits (and risks) of ownership⁵ (such as the right to holding gains (and losses) and receipt of the property/investment income attached to the security — are retained by the cash taker as if no change of ownership had occurred, in the same manner as when collateral is usually provided. “Full, unfettered ownership” means that the cash provider acquires ownership of the security and may sell it.

*Securities lending without cash collateral*⁶ is similar to a repo, except that no cash changes hands. The borrower obtains full and unfettered ownership in the same way, and instead of cash provides the lender with collateral, usually securities, and usually in excess of the value of the security lent. The lender of the securities does not acquire full and unfettered ownership of the securities received as collateral. The lender of the securities receives a payment from the borrower, which is usually called a “fee”. (This payment is discussed further below.)

Repos are usually undertaken as a liquidity management tool, and they are often used by central banks as part of their monetary policy. The benchmark interest in some countries is the repo rate. Securities lending is frequently undertaken to allow a broker to make delivery of a security that it may have sold short.

Statistical Treatment

In the *1993 SNA* and *BPM5*, because it was understood that the cash provider did not often have the right to on-sell a security acquired under a reverse repo, it was recommended that repos/reverse repos should be treated as collateralized loans. (Securities lending without cash collateral is not discussed in either document.) However, since 1993, the right to on-sell has become almost universal, and is very frequently exercised. It is this development that has caused the most difficulty in the classification of repos, as the recipient of the security that has been repoed (or lent) will not take it on to its balance sheet, and should the security be on-sold outright, it will result in a negative asset in the instrument involved being recorded⁷.

In view of the problems that repos and securities lending both pose for statistical measurement – that the ownership change is not recognized, and the two parties can claim ownership to the same security at the same time – the IMF Committee on Balance of Payments Statistics has given extensive consideration to the issue, at many meetings between

⁵ Except the right to sell

⁶ The term “securities lending”, in this context, covers both the borrowing and the lending of securities.

⁷ In some instances, the party on-selling the security will record a liability to return the security to its original owner.

1995 and 2003. The conclusion the Committee reached was that repos should be recorded as collateralized loans, and that if the security acquired under a repo were on-sold outright, it should be recorded as a negative asset in the instrument being on-sold. For securities lending, following the same logic as for repos, but as no cash is exchanged, no transaction should be recognized; if the security borrowed is on-sold (as it usually is), it should be recorded as a negative asset, in that instrument, by the party that borrowed the security. Following the work of the Committee, the InterSecretariat Working Group on National Accounts reached the same conclusion.

As part of the Committee's consideration of these transactions, however, several countries agreed to participate in a survey of financial institutions, to find out more about their internal recording practices for repos and securities lending. What emerged was that, among other things, a significant minority of those financial institutions that responded to the survey indicated that they record repos in what has come to be known as the "four way approach", that is, they record them as both collateralized loans and as transactions in the underlying security at the same time. Work by the Committee is continuing to explore the extent to which such an approach could be used for statistical purposes. If such an approach were to become widely adopted, or used for statistical purposes, it would overcome some of the problems inherent with repos and securities lending, as they cannot be considered to be unambiguously one transaction or another. A report will be taken to the AEG when more information has been obtained.

Another issue that has not been resolved is how to treat the payment for securities lending. This matter will be considered by the Committee, and a report will be taken to the AEG in due course.

Gold swaps and Gold loans or deposits

Background

Gold swaps are usually undertaken between monetary authorities. The gold is exchanged for foreign exchange deposits (or other reserve assets) with an agreement that the transaction be unwound at an agreed future date, at an agreed price. The monetary authority acquiring the foreign exchange will pay interest on the foreign exchange received. Gold swaps are typically undertaken when the cash-taking monetary authority has need of foreign exchange but does not wish to sell outright its gold holdings. In that manner, gold is a leveraging device. Gold swaps sometimes involve transactions where one of the parties is not a monetary authority (usually it is another depository corporation). Gold swaps between monetary authorities do not usually involve the payment of margin.

Gold loans or deposits are undertaken by monetary authorities to obtain a non-holding gain return on gold which otherwise earns none. The gold is "lent to" (or "deposited with") a resident or nonresident financial institution (such as a bullion bank) or another party in the gold market with which the monetary authority has dealings and confidence and which is probably acting as an intermediary for a gold dealer or gold miner which has a temporary

shortage of gold. The intermediary will, in turn, “lend” the gold to the dealer or miner – in effect, a change in ownership of nonmonetary gold then occurs. In return, the borrower may provide the monetary authorities with high quality collateral, usually securities (frequently, but not necessarily, substantially in excess of the value of the gold provided) but not cash, and will pay a “fee” thereby increasing the return from holding gold. The collateral does not change ownership and is treated as an off-balance sheet holding of the monetary authority⁸.

The nature of gold swaps and gold loans/deposits is similar to that of repos and securities lending in that the market risk toward the underlying asset (in this case, gold) remains with the original holder: if gold prices increase, the volume of gold returned is the same as that swapped, while the same value of the foreign exchange (as defined at the time of the initiation of the swap, plus any accrued interest) is returned.

Statistical treatment

The statistical implications of gold swaps and gold loans/deposits are complex and have not been fully worked through. Work is still being undertaken by the Committee to address the implications. In particular, gold may be double counted with either a gold swap or gold loan/deposit if the party acquiring the gold were to on-sell it outright, because both the original owner and the outright purchaser would report ownership of the gold. In addition, there is the difficulty of having monetary gold being used in these transactions for purposes other than for reserve assets, and how (de)monetization would apply if the gold is sold for industrial purposes. Moreover, there is a proposal to treat (some) nonmonetary gold as a financial asset, rather than a commodity, and the outcome of that discussion may have further implications on the treatment of gold swaps and gold loans/deposits. Finally, how the “fee” for gold swaps and gold loans/deposits should be treated has yet to be resolved. All these matters are being considered by the Committee and a report will be taken to the AEG in due course.

⁸ The collateral is retained on-balance sheet of the recipient of the gold loan or deposit.