



**CONFERENCE ON STRENGTHENING SECTORAL POSITION AND
FLOW DATA IN THE MACROECONOMIC ACCOUNTS**

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**Conceptual Issues Related to Residency and Nationality-based Balance
Sheets for Financial and Non-financial Corporations**

To be presented in Session by Karsten Von Kleist, Bank for International Settlements

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Conceptual issues related to residency and nationality-based balance sheets for financial and non-financial corporations

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Conference on Strengthening sectoral positions and flow data in the macroeconomic accounts (session 6)

Washington DC, 2 March 2011



Background: BIS

- Various statistical activities to support cooperative activities
 - CGFS and others: data collection, compilation, analysis, dissemination on key elements of international financial system
 - Secretariat Irving Fisher Committee on Central Bank Statistics
 - Member of various international groups (eg IMF BOPCOM, TFFS, Working Group on Securities Statistics, IAG)
- Expertise on key analytical, methodological and technical issues, in particular re international banking



Background: IAG

- Set up in late 2008 to address data gaps revealed by financial crisis
- Members: BIS, ECB, Eurostat, IMF OECD, World Bank, UN (IMF Chair)
- Input for FSB-IMF report to G20
- Follow-up on specific recommendations assigned to it
- Regular monitors implementation of all recommendations
- Develops and maintains website with Principal Global Indicators
- Members also key members of other groups, which facilitates cooperation and coordination



Background: IAG

- Task Force on G20 Recommendations 13 and 14
- Rec 13: “The IAG to investigate the issue of monitoring and measuring cross-border, including foreign exchange derivative, exposures of nonfinancial, and financial, corporations with the intention of promoting reporting guidance and the dissemination of data”
- Rec 14: “The IAG, consulting with the FSB, to revisit the recommendations of the G-22 to examine the feasibility of developing a standardised template covering the international exposures of large NBFs, drawing on the experience with the BIS’ IBS data, other existing and prospective data sources, and consulting with relevant stakeholders”



Background: IAG

- Members of Taks Force on Recommendations 13&14: BIS, ECB, Eurostat, IMF, OECD (BIS chair)
- Two objectives
 - Build inventory of current and prospective data and metadata on cross-border exposures of financial and non-financial corporations
 - Identify key conceptual, methodological issues related to cross-border exposures
- Workshop co-sponsored with IFC
 - Background issue paper to structure discussion
 - Summary of discussion being prepared
 - Paper serves as working document, shared only upon request



Background: IFC

- Formally established in 2006, Secretariat at the BIS, almost 70 institutional members
- Membership survey in 2010: financial stability issues of key importance to central banks
- Residency vs nationality view of financial positions identified as area requiring further analytical thinking
- Interested in organising workshop on the topic
- Offer to IAG to do so in context of work on G20 recommendation 13&14 (“consulting with relevant stakeholders”)
- Objective of workshop on 18/19 January 2011
 - Stimulate open, free discussion using IFC network
 - Raise awareness in international statistical community
 - Follow up, if any, is for other established groups



Evolving requirements for measuring financial positions

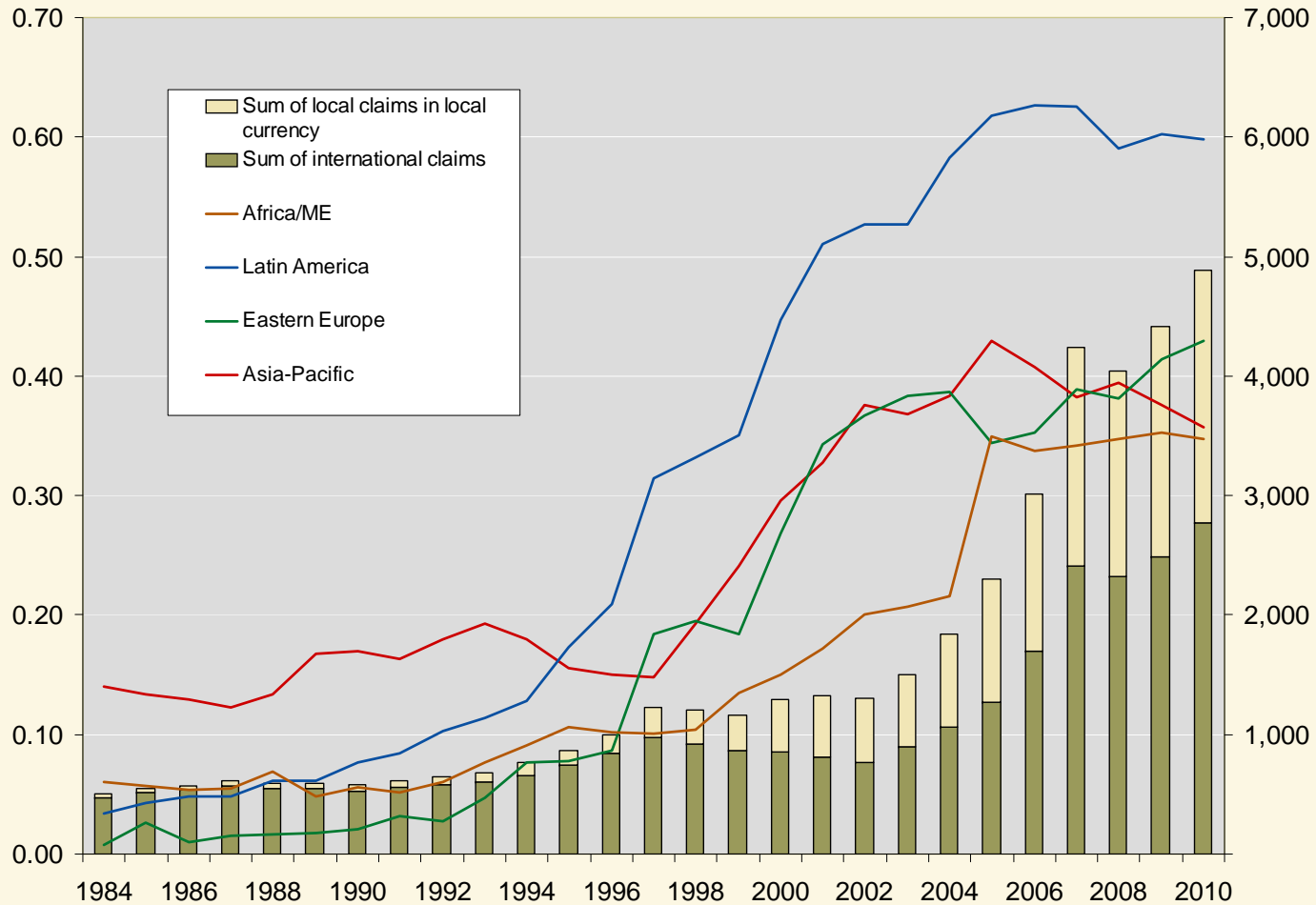
- SNA framework very useful to evaluate economic, monetary and financial conditions
- Does globalisation require to look beyond the residency-based approach?
 - From international to multinational banking and financial services
- Users want to measure not only “where” activities take place but also “who” and “how”
- Nationality of groups of institutional units becomes important as well as global consolidated balance sheets of national groups

Stylised presentation of the residency and nationality views of financial positions for an individual institutional (sub) sector

Residency.- Local	Home Country	Domestic institutional units		Foreign institutional units	
		Assets	Liabilities	Assets	Liabilities
	Host Country	Foreign affiliates			
		Assets	Liabilities		
		Nationality - Global			



Banks' local claims in local currency as percentage of foreign claims on emerging markets (lhs); foreign claims in USD billion (rhs)

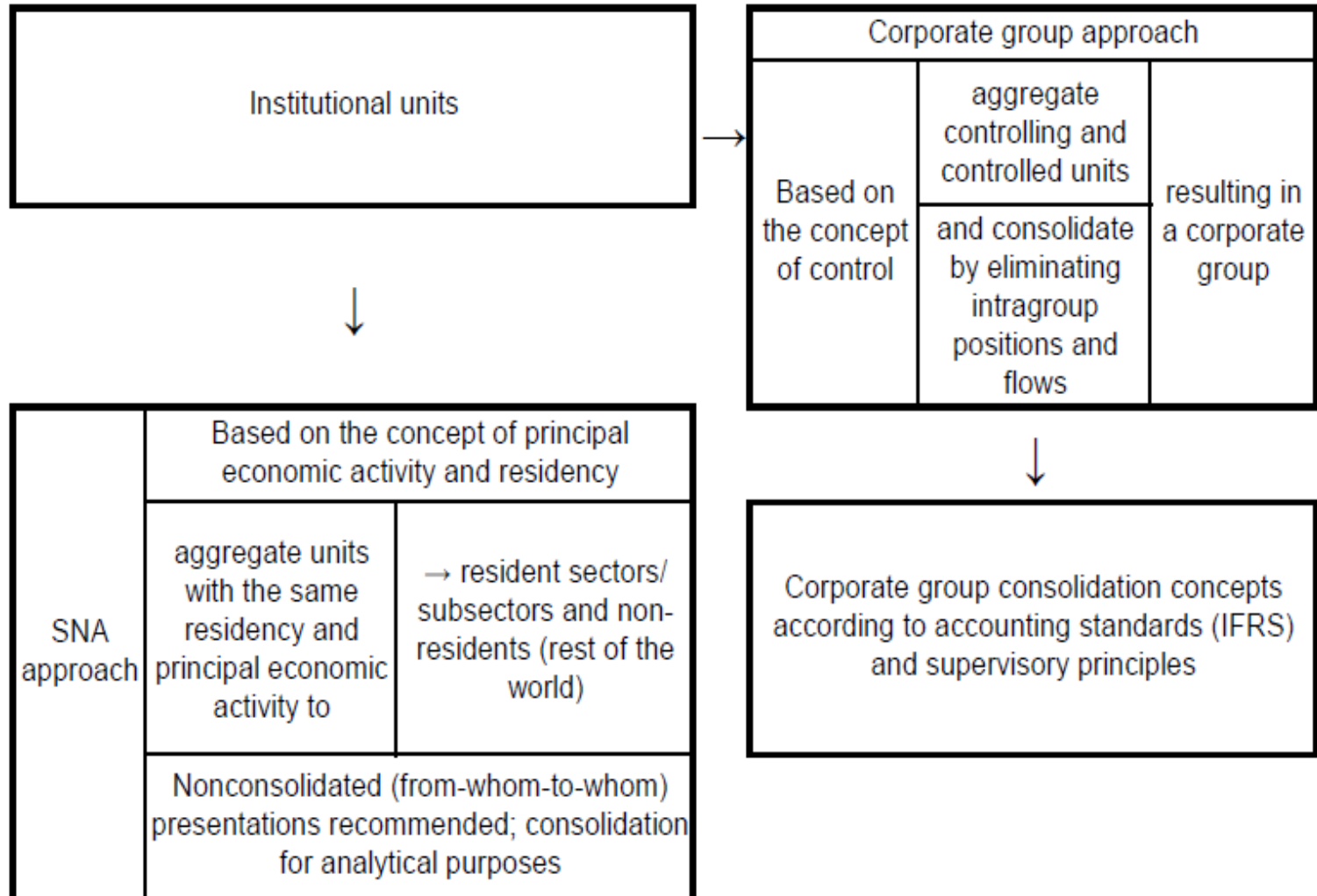




Evolving requirements for measuring financial positions

- Control of financial positions is not limited to residency, this implies a need to monitor the path of control
- Corporate group increasingly includes units resident in different economies (local vs multinational group).
- Recent crisis illustrates that stresses in financial institutions can build up across their globally consolidated balance sheets (assets and liabilities)
- Understanding control is important not only for banks but also for non-bank financial corporations and non-financial corporations (eg derivative transactions of multinationals through foreign affiliates)
- Currency, maturity and interest rate mismatches as well as measures of credit exposures important in context of globally consolidated data
- Accounting, bank supervisors, macroprudential/financial stability analysts have developed relevant frameworks, and some elements also available in statistical manuals

The SNA approach and the nationality/corporate group approach





Concepts, definitions, issues that require attention

- Preliminary list in background issue paper and in discussion at workshop
 - Residency and nationality, (sub)sectors
 - Corporate group
 - Control
 - Consolidation
 - Exposures
- Concepts and definitions interlinked
- Other issues
 - Reconciling residency and nationality view?
 - Applying nationality framework to NBFIs and NFIs?



Sectors, sub-sectors, residency and nationality

- (sub)sectors from SNA useful starting point also for financial stability analysts
- But institutional units also need to be differentiated and aggregated by nationality
- How to identify domestic units in their “home” country (nationality)
 - Ownership (very difficult)
 - Headquarter
 - Centre of corporate control
 - Jurisdiction of home country supervisor for financial companies
- Application in practice not easy: needs reconciliation exercise using business registers (eg BIS banking list)



Corporate group

- Different approaches possible
- Group financial positions according to accounting standards: very broad
- Prudential view of group financial positions: truncated or functional view
- Statistical view: SNA recommends classification by main economic activity (recognises desirability of having information for broad groups or conglomerates but notes limitations in practice)



Corporate group

- Various open issues
- What to do with conglomerates, holding companies, large complex financial services companies?
- More discussions needed with accountants, supervisors, financial stability analysts, statisticians
- Other G20 recommendations addressing similar issues (eg recommendations 8&9)



Control

- Various definitions/concepts exist: IFRS/IAS, SNA, BPM, OECD Benchmark Definition of FDI (BMD4), OECD Handbook of Economic Globalization Indicators
- Various open issues, including
 - ownership from 10/20% to 50%?
 - look through control chain to ultimate investor such as in CPIS?
 - Simple or more broad set of control criteria?
 - FDI statistics (BMD4) and Foreign Affiliates Trade in Services (FATS) statistics
- More discussion needed



Consolidation

- Common understanding across company and financial accountants and statisticians: method of presenting data for a set of units as if they constituted a single unit
- SNA and related manuals focus on sectoral consolidation
- BIS international consolidated banking statistics and FSI's focus on geographical consolidation, ie worldwide group consolidation
- Different approaches cover different user requirements
- Both approaches would argue for unconsolidated as well as consolidated data: in case of banks, for instance, interoffice positions are important information

Comparison of sectoral and geographical consolidation

Sectoral consolidation of financial positions	Global consolidation of financial positions
SNA approach for economic, monetary, fiscal and financial analysis	Accounting, supervisory, micro and macro risk management framework
Aggregated balance sheets of institutional sectors (subsectors) <ul style="list-style-type: none"> • Assets • Liabilities 	Individual and aggregated balance sheets of corporate groups on a functional basis <ul style="list-style-type: none"> • Assets • Liabilities • Off-balance sheet items • Profit and Loss
All resident sectors, no distinction of nationality	Domestic entities only
Breakdowns by <ul style="list-style-type: none"> • Financial instrument categories and sub-categories (loans, debt securities, financial derivatives) • Counterparties (resident institutional (sub)sector, vis-à-vis country) • Currency and maturity envisaged in Balance Sheet Approach 	Breakdowns by <ul style="list-style-type: none"> • Instrument (loans, securities, derivatives) • Counterparties (institutional sectors, private/public, vis-à-vis country) • Currency • Maturity • immediate and ultimate counterparties
In principle, non-consolidated presentation (incl from whom-to-whom view) Consolidation by economy, sector, subsector possible for analytical purposes	Global consolidation of positions/exposures within individual corporate groups No intra-sector or inter-sector consolidation (gross positions and exposures) Identification of inter-office (intra-group) positions



Exposures

- Exposure = expected loss incurred when certain risk materialises
- Broad and narrow interpretation
 - Narrow: probability of default times loss given default (BCBS)
 - Broad: an asset or off-balance sheet item (full value)
 - FSB not yet pronounced on this
- Useful to distinguish level of aggregation
 - Micro to micro or individual to individual
 - Micro to macro or individual to aggregate
 - Macro to macro or aggregate to aggregate



Exposures

- Not all micro risks and exposures can be aggregated to macro/systemic risk
- Try to ensure consistency across levels of aggregation
- Challenge: marry views of accountants, bank internal risk managers, supervisors, financial stability analysts and statisticians
- Many types of risks and related classifications: bewildering?
- Macro statistics try to capture risks and exposures through appropriate breakdowns in data on financial positions



Types of risks

- Fundamentally two types of risks
 - Liquidity risk: ability to meet commitments: funding risk, maturity and currency transformations and mismatches, interest rate risk, roll-over risk ...
 - Credit risk: losses related to counterparty default ...
- Two approaches
 - Immediate obligor basis: gross balance sheet positions; assets and liabilities
 - Ultimate risk basis: exposure measures that take account of elements that identifies ultimate obligor such as guarantees, commitments, (credit) derivatives, control relationships, legally binding netting; focus on claims (assets)



Types of risks

- Immediate obligor basis in line with financial positions from residency framework; ultimate risk basis could be very different
- BIS banking statistics follow both approaches and can measure, in principle, two fundamental risks and related exposure
- Substantial Outward risk transfers (\$1,431 billion) and inward risk transfers (\$1,467 billion), amounting to around 8% of foreign claims, but ..
- some countries currently report only net risk transfers

Consolidated foreign exposures of BIS reporting banks¹

Positions outstanding at end-June 2010, in billions of US dollars

	Basis for risk allocation		
	Immediate borrower	Net risk transfers ³	Ultimate risk
By type of exposure			
Claims (loans and securities) ²			
Foreign claims	24,779	-226	24,553
Cross-border claims	International claims ⁴ }		13,176
Local claims – in foreign currency		14,634	}
– in local currency	10,145	11,377	
Derivative contracts			4,430
Contingent facilities			
Guarantees extended			6,886
Credit commitments			3,573



Issue: applying nationality/group consolidation framework to non-bank financial corporations and non-financial corporations

- Complementary new framework so far only applied to banking statistics
 - BIS international banking statistics, FSI's: quite challenging to have consistency
 - Also challenge to adapt methodology over time: changes in accounting, supervisory practices, requests from financial stability analysts
 - Advantage of having established reporting systems and supervisory authority
- Data on international exposures of other sectors all on residency basis, ie claims and liabilities of institutions in particular sector in particular country vs non-residents



Issue: applying nationality/group consolidation framework to non-bank financial corporations and non-financial corporations

- Non-bank data currently from
 - OECD: institutional investors, global pension and global insurance statistics
 - ECB: insurance, pension funds, money market and investment funds, financial vehicle corporations, other financial intermediaries
- No relevant balance sheet data for cross-border exposures for non-financial corporate sector: proposal to use FDI statistics as the starting point and to complement further.

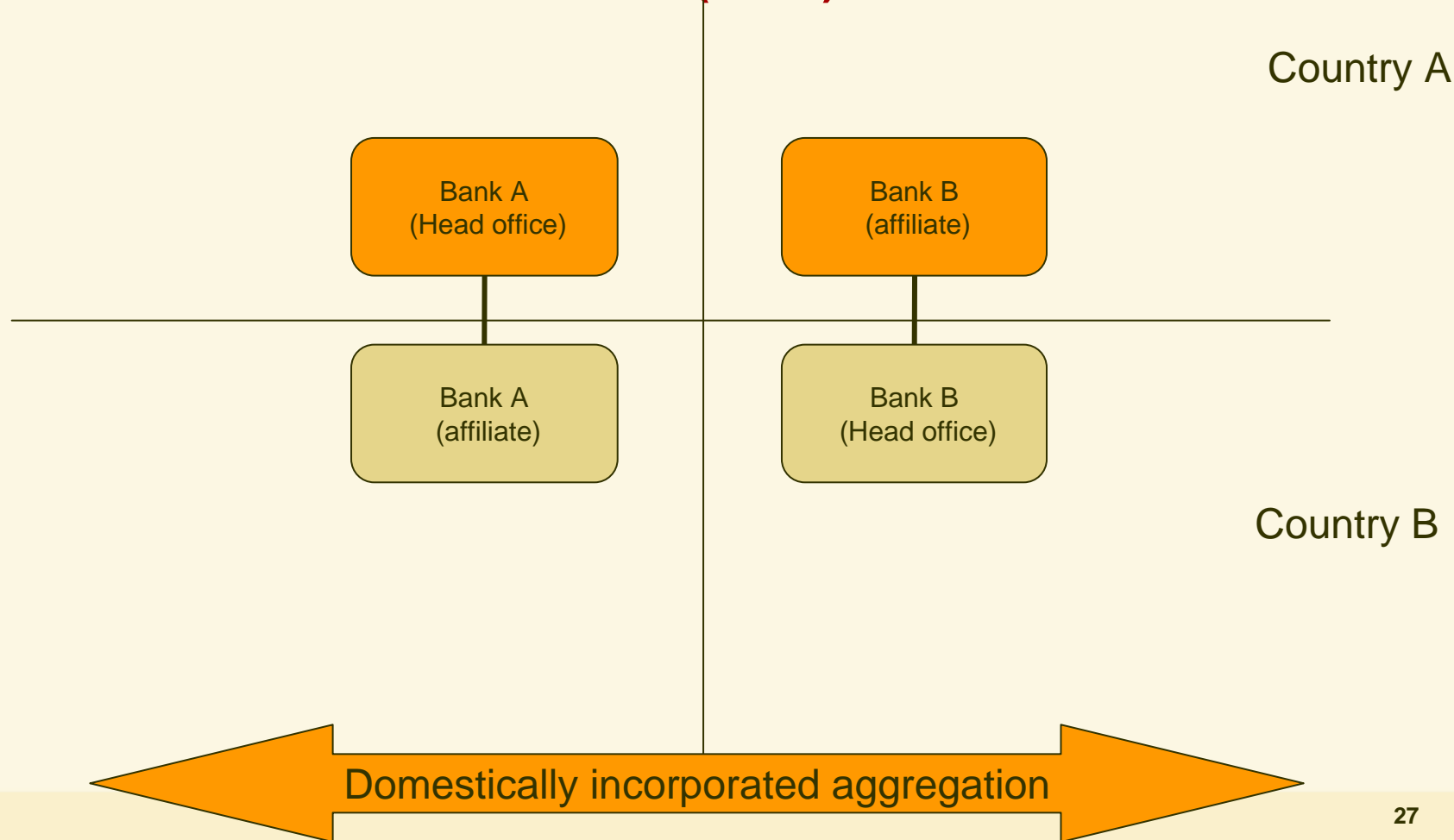


Issue: reconciling residency and nationality views?

- Nationality/group consolidated view can be built on concepts, definitions, classifications from existing international statistical standards
- Could residency and nationality approaches be reconciled? Two country model vs three country model for multinational business?
- Views differ: agreement in theory and with simplifying assumptions, difficult in practice
- Would work for immediate borrower basis but no longer for ultimate risk
- More analysis and discussion needed

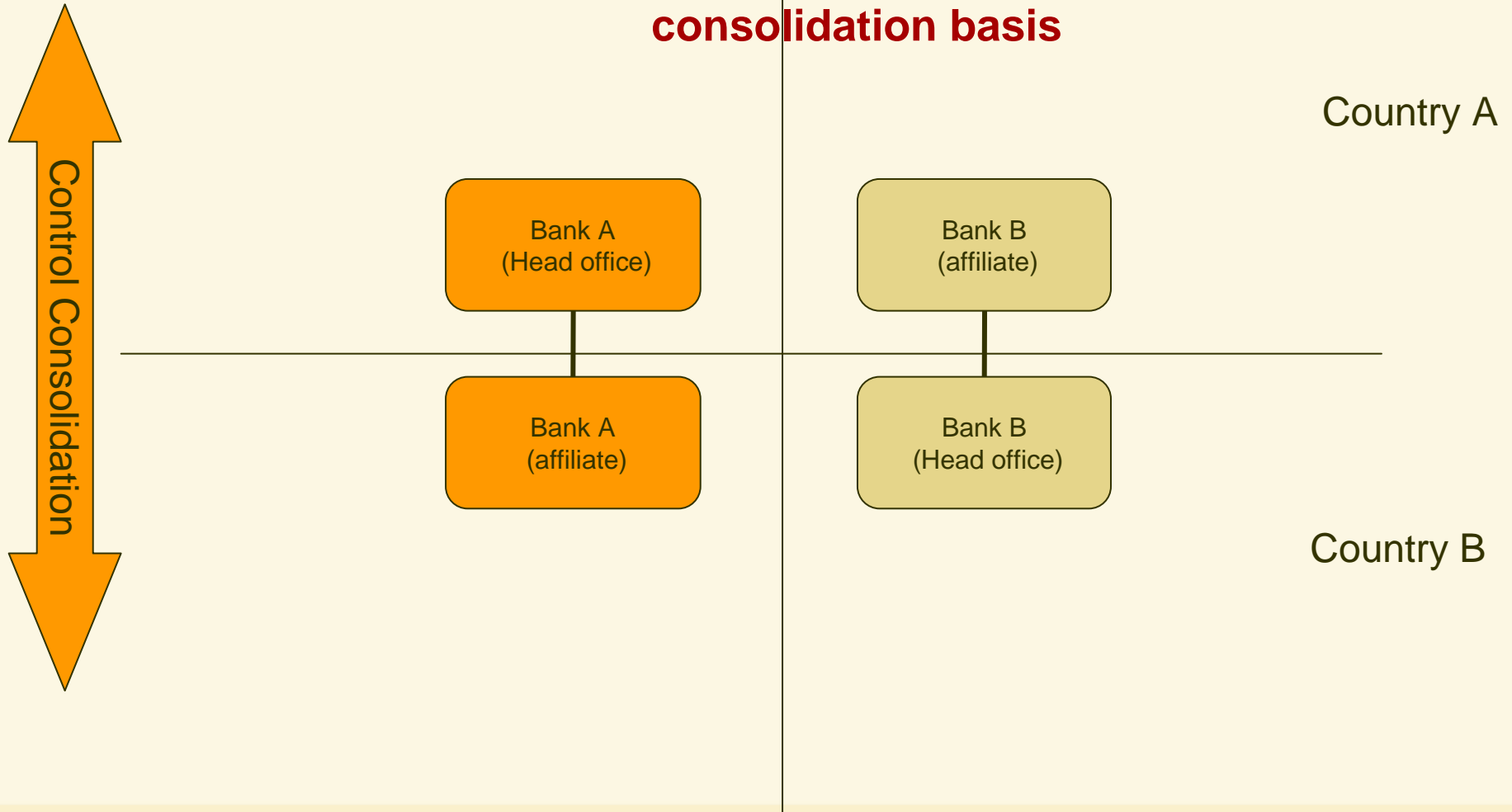


BIS “locational” statistics by residence, (similar to FSI Cross-border consolidation basis for all domestically incorporated entities (CBDI))





**BIS “locational” statistics by nationality, similar to FSI
Domestically controlled, cross-border (DCCB)
consolidation basis**





General observations

- Agreement on growing importance on analyzing control issues (nationality/group) via consolidation
- Expertise with such an expanded framework for financial positions data exists in banking area
- Relevance for other (sub)sectors may differ
- Challenge to combine and reconcile accounting, supervisory and statistical approaches



General observations

- Different views exist
- Cost/Benefit: Data could be mostly derived from existing building blocks (residency, regulatory data). Information on control of economic positions provides helps policy makers.
- More analysis and clarification needed, including with macroprudential analysts, supervisors, compilers
- Usefulness of User Guide, Reference Document accepted:
 - based on existing guidelines as much as possible
 - could be used to complement existing, and develop new, data compilations in the future



Next steps

- Summary of workshop being prepared
- Background paper and summary not published but available upon request to relevant stakeholders
- Follow-up report by Task Force to IAG then to G20
- Implementation of website linking available data and methodologies re cross-border exposures of financial and non-financial corporations
- Agree on outline of possible User Guide, Reference Document
- Consult with major stake holders and interagency partners
- First part possibly in early 2012 focusing on evolving user requirements for financial positions data and conceptual framework to address it



Conclusion

- G20 Recommendations 13&14 important to address existing and future data gaps, particularly as a result of continued globalisation
- Active work in IAG and consultations with stakeholders started, will be continued
- Consensus to develop reference document to support existing and future data compilations with respect to international exposures of financial and non-financial corporations – stepwise approach envisaged