
Developing financial statistics for policy

Progress report: January 2011

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Summary

The July 2009 special edition of the *Economic & Labour Market Review (ELMR)* included a series of articles reporting progress on work that was launched in the autumn of 2008 as the ONS's response to the financial crisis. Those articles included 14 recommendations that, when implemented, would improve financial statistics in the UK, particularly in the context of their inclusion in the National Accounts. This note reports progress on the further work that has been undertaken since that time on those recommendations and other related issues that have emerged in the last year. It concludes that there have been a number of improvements to the National Accounts arising from this work although there is more to do. However, future projects may be more focussed on meeting macroprudential policy needs rather than improving the National Accounts per se.

Introduction

The ONS has identified three roles in relation to financial statistics:

- to provide the tools to help policy makers and analysts understand the mechanics of the credit boom
- to keep pace with financial innovation in the collection and presentation of the statistics
- to contribute to the transparency agenda, particularly in relation to the shifting of risk from the private to the public sector balance sheets

In response to the financial crisis and to assist in the undertaking of these roles, ONS launched a project in the autumn of 2008 to examine how the statistics were recording the credit boom and the financial innovation of recent years and what improvements might be made for the future. It also aimed to raise the profile of Sector Accounts more generally in macroeconomic analysis and in particular, looked at how to record the continuing effects of the financial crisis and the effects of government interventions. The major focus of the work was, and has continued to be, on financial balance sheets and financial transactions.

Five detailed articles were produced and published in July 2009 covering:

- the impact of the financial crisis on the output and employment measures of the financial sector (Williams, Fender and Drew 2009)
- how the evolution of the credit boom might be detected in the sectoral balance sheets, including an analysis of gaps in the recording of assets and liabilities largely arising from the emergence of the 'shadow banking system' (Davies 2009)
- issues affecting the household sector balance sheet (Daffin, Levy and Walton 2009)
- issues raised by banking groups coming into the public sector (O'Donoghue 2009); and
- a discussion of the extent of government financial liabilities under different definitions extending beyond public sector net debt (Maitland–Smith 2009)

Additionally, a concluding article was also published outlining a number of recommendations from the project.

Progress report

The following is a report on the current state of play against each recommendation alongside two further priority action points (numbers 15 and 16) that were identified when the plan for further work was drawn up.

Recommendations 1 and 2

1. ONS should publish, after consulting other stakeholders, the analysis it has done on gaps in definition and coverage of reporting on financial services, products and entities as a basis for future joint work.

2. A forum for active cooperation with the Financial Services Authority (FSA), Bank of England and HM Treasury and other stakeholders should be developed, with a view to filling the gaps, and improving existing data.

- On track to be completed in early 2011.

As part of the strategy of engagement with users on wider economic statistics, an Economic Statistics Theme Group has been set up to fulfil the National Statistician's requirements for user engagement on the National Statistics Economy Theme. This group met for the first time on 29 July 2010 and, at that meeting agreed to set up a sub–group of expert users of financial statistics to fulfil the role envisaged by the recommendation. The terms of reference are shown in **Annex A**.

The sub–group met for the first time on 25 November 2010 and noted the work carried out so far. It discussed the priorities for future work and in particular, the feasibility of producing 'Flow of Funds' for the UK similar to those published for the USA by the Federal Reserve. It also considered the ONS analysis of gaps in reporting and an article reflecting these discussions will be published in a forthcoming edition of ELMR.

Recommendation 3

3. *Data on derivatives are available and should be incorporated into the National Accounts at the earliest opportunity.*

- Partly implemented in 2010 *Blue Book* – full implementation in 2011.

Data on derivatives in the banking sector have been incorporated into the 2010 *Blue Book* from 2006, the earliest period open for revision (Cullinane 2010). Data for earlier years will be taken on in the 2011 *Blue Book*. Information on securities dealers' transactions in derivatives was collected for the first time in 2009 and will also be included in the 2011 *Blue Book*.

Recommendation 4

4. *A review of bonds transactions should be carried out, focusing on the reconciliation of data between the income and capital account and measures in the financial account.*

- Completed in September 2010 for implementation in 2011 *Blue Book*.

A review of the current sources and methodology for bonds transactions has been completed. It found that the Bank of England's Bank and Building Society Balance Sheet survey could provide a more consistent data source for bank and building society debt securities liabilities than the current method. It confirmed that the London Stock Exchange provides high quality data on quoted debt securities issued by private non-financial corporations (PNFCs) and other financial institutions (OFIs), the latter being a consistent source for insurance and pension funds debt securities.

A review of the processes and methodology identified errors in sector allocations for some individual companies. A corrected master list for allocating debt securities data to sectors has been created. Data from the Bank of England and London Stock Exchange are both provided at nominal (or book) value. This is contrary to the requirements of the System of National Accounts (2003) (SNA2003) and the European System of Accounts (1995) (ESA95), which requires debt securities to be at market valuation. The review has developed a method using general indices of bond prices to convert the data from a nominal valuation to a market one to meet these requirements.

Finally, the review recommended that the presentation of bank and building society debt securities of differing maturities in different transaction lines should be stopped. It was causing confusion among the users of these statistics. Instead a single transaction line for UK debt securities should be used.

A fuller summary of the review is included in **Annex B**.

Recommendation 5

5. *Estimates of the gross trading profits of fund managers should be improved, given that they are thought to have been underestimated since the cessation of the Fund Management survey in 2000.*

- Some improvements made – further work needed.

The project looking at the methodology for estimating the gross trading profits (GTP) of fund managers fed into a wider project looking at aspects of GTP of financial companies more generally and household expenditure on investment in unit trusts. The work has led to improved methodology for the GTP of unit trust and investment trust companies, largely through the use of a more consistent set of component data. These changes were taken on board for the 2010 *Blue Book* estimates leading to small overall revisions of financial companies' GTP. The work also improved estimates of expenditure by households on investment in unit trusts by bringing the methodology into line with that used in the financial corporations GTP calculation. This provides for consistency across the measures of gross domestic product (GDP).

The further work on fund managers' GTP will continue. The Investment Management Association (IMA) are interested in this work and are undertaking their own project looking at the gross value added of fund managers. This work is scheduled to be picked up shortly.

Recommendation 6

6. Estimates of the gross trading profits from asset finance activity should be broken down by asset type, which in turn will improve the validation of finance leasing data.

- Improvements made to survey output. Further work needed to redesign the survey to meet National Accounts needs to be included in implementation of European System of Accounts 2010 (ESA10).

Work on the Asset Finance survey has fallen into two distinct parts. *Business Monitor SDQ7*, reporting the results for this sector, has been extensively revised and improved. Previously it gave a number of indicators for a few aggregates. A review showed those to be unreliable, while the eclectic group of indicators chosen was not the most useful set and it was not clear to all contributors and commentators how they mapped to the information requested from asset finance businesses. The Business Monitor now reports much more closely the results of the survey, with more data available, of higher quality.

In addition, a review of the current survey methodology was undertaken and made a number of recommendations. These detailed recommendations are listed in **Annex C** and will be prioritised against other developments. One possible outcome is that they will be implemented alongside any changes to the survey questionnaire that are needed in order to meet the requirements of ESA10. The set of National Accounts that are due to be published in September 2014 will be produced on an ESA10 basis.

Recommendation 7

7. A top-to-bottom account for banks should be developed to improve quality assurance and sectoral balancing.

- Improvements made in 2010 *Blue Book*. Some further development needed to make full use.

ONS is moving towards a policy of using the information collected by the Bank of England in its surveys of the monetary and financial institutions (MFI) sector as the primary source, rather than counterparty or modelled information. For the 2010 *Blue Book*, there was a significant improvement to the account for banks that arose from using Bank of England data on interest paid and interest received. For the future, a system has been developed that creates a top-to-bottom account for validation purposes but this needs further testing before it can be used more widely.

Recommendations 8 and 9

8. A volume measure of the output of hedge fund managers is needed, given that they are estimated to make up around 6 per cent of fund management activity.

9. The quarterly output of financial advisors and mortgage brokers is not currently measured and potential data sources should be investigated.

- Review completed which concluded no immediate need for alternative sources.

The recommendations were to investigate whether any volume indicators existed for hedge fund management activities, mortgage brokers and independent financial advisors. All these sectors belong to division 67 of the Standard Industrial Classification 2003 (SIC 2003) and therefore a broader review of the current methods used to measure output in this division was conducted, in particular looking at whether coverage and methods could be improved and/or extended.

The review encompassed a detailed investigation of the methods and concluded that current methods provide adequate coverage of the division. However, the review has yielded a number of recommendations that could improve the quality of the statistics. Some of these recommendations are being addressed as part of the current systems development. Other recommendations will be revisited once the GDP output (GDP(O)) measure calculation is fully integrated into the new system allowing further methods changes to be made. The review also highlighted the need for improved price deflators in this area. It is clear that one of the biggest improvements in quality to the measurement of this division would come from obtaining improved price deflators. The progress of the Services Producer Price Indices (SPPI) development project (Jenkins, Jones and Pegler 2010) will continue to be monitored and as indices are developed they should be assessed for inclusion into the quarterly GDP(O) measure.

In answer to the specific recommendations, the review concluded that no suitable output indicator currently exists for hedge fund managers and that their potential gross value added weight is too low to warrant further investigation or development at the current time. Hedge funds themselves may potentially be more important for the Financial Account and Sector Accounts than for the quarterly GDP(O) measure.

For mortgage brokers, a potential output indicator was identified (but at a cost), and further investigation into its suitability would be needed before it could be introduced into the quarterly GDP(O) calculation. However, until a value indicator or suitable price deflator can be identified, introducing this volume indicator is not possible. Further work will be prioritised against other possible improvements to GDP(O) sources more generally. Similarly, the review found that very little data exists for independent financial advisors and nothing that could be used in the quarterly

GDP(O) calculation. For both areas, the potential gross value added weight would mean any indicator would be unlikely to have a significant impact on the quarterly GDP(O) measure.

In the light of the review it was decided to consider the recommendations alongside other improvements to the quality of GDP(O) as part of next year's planning process.

Recommendation 10

10. ONS's work on improving its price indices for deflating banking sector output should be revisited and use of the current deflator (based on earnings) reviewed.

- To be taken forward as part of more general projects on deflators and the development of SSPIs.

A work programme will be established aimed at extending the use of existing SPPIs as deflators in the National Accounts. The priorities for further development of SPPIs are largely determined by the requirement to meet EU Regulation and the development programme does not currently include further work on the banking sector.

Recommendation 11

11. Development of the Securities Dealers' survey should be treated as a priority, including finding solutions to existing data discontinuities and conceptual difficulties with deflation.

- Questionnaire changes to collect information on derivatives implemented for 2010. Data changes will be implemented from 2011 *Blue Book*. More extensive changes to the questionnaire will be necessary to reflect changes arising from ESA10.

There were three strands to this project. First, the questionnaire was changed to include data on derivatives in line with that collected from the banking sector by the Bank of England. The additional data was collected in the new questionnaire from Q1 2010.

Secondly, the use of the data on the current Securities Dealers' questionnaire in the compilation of National Accounts has been reviewed and changes identified that will be implemented in the 2011 *Blue Book* along with the inclusion in the accounts of the additional information on derivatives.

Thirdly, the Securities Dealers' survey questionnaires will be changed to facilitate the collection of ESA10 changes. A seminar was held in London with some participating companies in early March 2010 and generally there was a positive response. Work will be ongoing with the introduction of the new questionnaire in line with the timetable for making ESA10 changes more generally.

Recommendation 12

12. ONS should pursue the objective of publishing data separately for the public financial corporations sub-sector.

- Nearing completion.

Lloyds Banking Group and RBS were classified as public sector institutions from October 2008. This project will fully incorporate the two banking groups into the Public Sector Finances.

The general approach that is being followed is to reuse data provided to the Bank of England or ONS for other statistical purposes. In order to achieve this, work has been proceeding on several fronts, each of which is drawing to a conclusion, so that ONS should soon be able to publish the required PSF data.

The main strands of work are as follows:

- for the banking subsidiaries, ONS has worked closely with the Bank to specify the series required from surveys conducted by them, and has engaged with RBS and Lloyds Banking Group to agree which series can be supplied when, so that commercially sensitive data are not released
- For financial companies that are not banks, ONS has been reworking survey data provided to it, to obtain the required PSF series
- For non-financial companies, ONS has been recruiting the biggest subsidiaries into its quarterly survey, and using annual accounts for smaller companies

Recommendation 13

13. ONS should move progressively towards comprehensive coverage of public sector assets and liabilities.

- Initial article published in July 2010 (Hobbs 2010a) and updated in September 2010 (Hobbs 2010b) to incorporate new balance sheet information from the 2010 *Blue Book*.

The project is to build upon earlier examinations of the boundaries of public sector debt, for example those in the *ELMR* articles by O'Donoghue (2009) and Maitland-Smith (2009).

The aim initially is to provide an overview of the scope of 'public debt', clarifying those aspects that are not currently included, and to bring together those data that currently exist from a range of sources. It is proposed that a series of more detailed articles on specific aspects of public sector debt (pensions, PFIs, contingencies and guarantees and so on) would follow in due course.

In terms of the proposed future in-depth articles, further stakeholder engagement will be necessary to establish the type of debt measures users will need in future. Much will depend on resources available and the impacts of possible restructuring within departments (including who will lead on this type of work).

Recommendation 14

14. ONS should work actively with Eurostat to develop tables of total pension liabilities in line with the 2008 System of National Accounts.

- On track for implementation alongside 2013 *Blue Book*.

The estimates of pension liabilities in line with ESA10 are on track to be published alongside the 2013 *Blue Book*, in line with the agreement with Eurostat, and may be published earlier if resources allow.

Recommendation 15

15. ONS should support the production of a set of *Generational Accounts for the UK* to allow analysis of the long term impact of the government interventions in the financial sector, on tax rates and spending possibilities for future generations.

- A seminar was held on Generational Accounts in July 2010 and an article was published describing what Generational Accounts are and how they might provide indicators of the sustainability of fiscal policy (Chandler and Phelps 2010).

ONS wanted to contribute to the wider debate on fiscal sustainability and commissioned a project to construct Generational Accounts for the UK in line with Cardarelli, Sefton and Kotlikoff (2000). The aim is to provide an alternative view of the long-term public finances to complement that in the Treasury's long-term public finance report.

The research work for this project was successfully contracted to a group consisting of National Institute of Economic and Social Research (NIESR) head Martin Weale and James Sefton, currently at Imperial College. The researchers have obtained and provided ONS with age-sex profiles of spending on all the key public services except primary care in health. Work has been completed to process these profiles and expenditure projections, compute the final Generational Account for the UK including an estimate of the intergenerational budget balances. These actions have been performed mainly by NIESR, with ONS mainly involved with managing the partners and the organisation of final dissemination.

Due to a change in government since the forecasts were collected it was decided that before publication of an article by NIESR based on the results from their model that a review of the initial departmental forecasts was carried out. ONS is now in negotiations with Office for Budget Responsibility (OBR) to check the initial departmental forecasts. It seemed appropriate to request that the OBR do this checking as they now have responsibility for forecasting. OBR have also been asked if they would be interested in taking over management of the model for producing Generational Accounts and making it available for analysis as this sits more comfortably with their remit than ONS's.

Recommendation 16

16. ONS should review the content of the *Financial Statistics* publication.

- Review of *Financial Statistics (FinStats)* publication due by March 2011.

In line with ONS publication policy more generally, from August 2010, the *FinStats* publication will not be produced in paper form. From that time until May 2011, when the new ONS website is due to be fully introduced, the publication will continue to be produced in online pdf format. After May

2011, it is unclear whether *FinStats* can continue to be produced in its current form and a review of its form and content is planned. The expert group formed in response to Recommendation 2 will be consulted as part of this review as well as users more generally.

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Annex A: Terms of reference for Expert Group on Financial Statistics

The ONS has identified three roles in relation to financial statistics:

- to provide the tools to help policy makers and analysts understand the mechanics of the credit boom
- to keep pace with financial innovation in the collection and presentation of the statistics
- to contribute to the transparency agenda, particularly in relation to the shifting of risk from the private to the public sector balance sheets

The Expert Group will advise ONS on these roles and, in particular, on issues relating to the collection and publication of financial statistics. It will identify:

- emerging issues in financial products in order that data collection systems are kept up to date
- alternative sources of financial statistics and advice on their appropriateness
- gaps in the statistical system in relation to financial statistics and prioritise the filling of these gaps
- a range of indicators to assist in the monitoring of macroprudential risk
- improvements to the presentation of financial statistics, in particular in relation to the *Financial Statistics* publication

The following organisations will be represented on the Expert Group:

- Office for National Statistics
- HM Treasury
- Bank of England
- Department for Business, Innovation and Skills
- Financial Services Authority

Meetings will be held twice a year with more urgent issues being dealt with by correspondence.

Annex B: Review of bonds transactions

The main aims of the project were to review current data sources for debt securities, and consider alternative sources, in order to provide estimates at market value. New estimates needed to be consistent with information published by other institutions, especially the Bank of England and meet valuation requirements for market prices for levels and flows.

The review covered debt securities issued by UK banks and building societies and other UK residents and made the following key recommendations:

- **Replace bank and building society bond liabilities data with that from the Bank of England's Bank and Building Society Balance Sheet survey**

Using data from the Bank of England's Bank and Building Society Balance Sheet survey constitutes an improvement in the quality of the debt securities liabilities data. Data will now be taken completely from the Bank of England aggregates, replacing the current compilation method where the logic behind data sourcing and compilation formulae was inconsistent and unsatisfactory.

- **Incorporate London Stock Exchange data for insurance and pension fund listed debt securities liabilities**

The current data source for insurance and pension fund debt securities liabilities is solely sourced from the ONS Foreign Direct Investment survey. The review recommends augmenting the insurance and pension fund debt securities liabilities with data on quoted debt securities liabilities from the London Stock Exchange which is already used for non-financial corporations and other financial institutions, thereby improving the coverage of this sector's debt securities liabilities.

- **Provide a methodology to convert debt securities liabilities from nominal (or book) value to market value**

In line with SNA2003/ESA95 requirements for market prices, the review recommends converting the liabilities from a nominal (or book) valuation to a market valuation.

The proposed methodology to convert debt securities from nominal (or book) value to market value is to use a weighted composite bond price index. The method weights together bond price indices denominated in euros, US dollars and sterling using weights derived from the amount of outstanding bond debt.

- **Incorporate refinements to the debt securities sectorisation**

The review discovered some misallocation of companies between the national accounts sectors. Therefore, recommends correcting these entries and going forward introducing a high and consistent standard of vetting for sectorisation.

- **Combine data for transaction lines UK issued bonds**

Bank and building society liabilities greater than 5 years being allocated to transaction line titled 'bonds issued by other UK residents'. The bond review recommends combining bond issued by UK banks and building societies and other UK residents into one line, as a consistent category across all sectors rather than the current confusing allocation.

Further work

In the early stages of the review, the European Central Bank 'Centralised Securities Database' was considered, but then discarded in the short-term. However it should be investigated as a possible longer-term option.

The review has not made proposals on debt securities interest payments which form part of property income (D.4) within the allocation of primary income account. Additionally, it was not possible to investigate alternative methodologies for sector asset holdings of UK debt liabilities, nor a review of UK holdings of overseas debt (F.3329). A subsequent project should be undertaken to cover these points once resources are available.

Annex C: Improvements to the Asset Finance survey

As part of the work carried out in response to Recommendation 6 relating to the Asset Finance survey, a number of possible improvements were identified. These are listed as follows and will be prioritised against other statistical developments more generally.

- Work on identifying the businesses in the sector should continue. This will involve matching the ONS's Business Register with Trade Association membership files. Research into the possibility of obtaining additional variables from the trade association to identify industry specific key businesses and to ensure improve the survey methodology is also needed.
- The three SICs that are covered by the survey (Factoring, Credit Granting and Finance Leasing) need to be analysed separately. Further consideration should also be given as to which of the information is needed quarterly and which can be collected annually.
- There is a need to calculate historic data for all variables from 1999 to current period.
- Consider the role of the SDQ7 publication in the dissemination of data on asset finance. The publication of data from the Asset Finance and Monthly Credit surveys needs to be more coherent. The Financial Statistics publication could include the results of any new Asset Finance Survey.
- As part of a broader user engagement strategy, regular annual liaison with the relevant Trade Associations should take place to help keep up to date with industry developments and to take account of user needs as the survey is developed.