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OECD EDG ON CONSOLIDATION: COUNTRY COMMENTS

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WORKING PARTY ON FINANCIAL STATISTICS

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Introduction

It was proposed in October of 2005 by the Chair of the WPFS, and accepted by the secretariat, that an OECD electronic discussion group (EDG) is set up on consolidation. The objectives of this EDG would be to address the issues of consolidation before the WPFS; and, to contribute to the SNA93 revisions' process as a clarification item on consolidation. The EDG will report its findings to the WPFS to the October 2006 meeting. This paper is part of that process.

This paper presents (in full) the views of EDG members, so as to avoid any misinterpretations in the EDG summary document. This paper excludes input from Canada, which is articulated in the submitted and posted papers:

- *Consolidation in OECD databases*
- *Consolidation in SNA*

This paper presents the comments in the order of receipt.

United States (Susan McIntosh, U.S. FRB Flow of Funds)

I have read your two documents and they actually shed some light for me on the whole issue. On the whole I think you are on the right track and your documents are very informative and I support your recommendations. Please note specific comments below.

Consolidation of Financial Data in SNA93

- With regard to the SNA document, I totally agree with recommendation 1 on having the principal method for the accounts be not consolidated. As I think you said a consolidated financial corporations sector makes no sense in financial accounts.
- *A consolidated government sector, as in recommendation 2, is ok and we do show one as a supplemental table for the IMF.*
- With respect to recommendation 3, I agree. We do not in general net financial instruments except in the case of inter-bank loans and some sector's fed funds and rps.
- With regard to recommendation 4, I agree. It is common to you have a consolidation of related legal entity corporations that can not be split apart. Notably, we struggle with getting data for the domestically-booked corporation. The consolidation of their worldwide operations is a major problem. Also we struggle with removing financial subs from the non-financial corporations' data, for example GE credit from GE the non-financial corporation.
- I support recommendation 5 on making a contribution to the next revision of the SNA.

Consolidation of Financial Account and Balance Sheet Account data in OECD databases

- Regarding the recommendations for the OECD, the US sub-sector estimates are also partially consolidated and I have never figured out under which heading to report our data.
- Recommendation 1 is fine and it is important to have in the notes which method is used but must countries submit both? As I mentioned above, complex organizations are a major issue for the U.S. We continue to find it harder to get the right part of organizations for the accounts.
- I would support recommendation 4 which requires only one set of data with notes since the *consolidated* and *non-consolidated* labels do not work well for us either.
- And, of course, I support recommendation 5 on making a contribution to the next revision of the SNA.

United Kingdom (Chris Wright, Bank of England)

The issues raised by these papers (*Consolidation of Financial Data in SNA93, Consolidation in OECD databases*) are important ones and long overdue for discussion. In the context of macroeconomic financial statistics, the concept of consolidation is one which statisticians generally consider to be fundamental, yet comparisons of country practices too often reveal differences of understanding, preference or detailed treatment sufficient to challenge the aim of harmonized standards for the presentation of data. Three specific practical issues mentioned in the Canadian papers are briefly reviewed here: the user concepts of consolidation; the cost benefit case for multiple presentations; and the issue of hybrid (partially consolidated) presentations. The conclusions drawn here leave me supporting the principal recommendations presented at the end of the two papers.

User Concepts

Our statistical frameworks will be of little worth if they cease being relevant to user needs. The Canadian papers recognise the importance of developing statistics to meet user concepts although the case is put substantially in the context of a simple choice between consolidated and unconsolidated financial account and balance sheet data. In practice, the demands on financial statisticians have expanded very substantially in recent years. Specifically, the rapid growth in macro prudential analysis has led to the development of a wider range of user concepts, including a family of alternative approaches to the aggregation and consolidation of balance sheet data. While the general principle of cancellation of intra sector flows and positions remains much the same, the basis for defining the sector and the associated interest in subsectoral analysis has greatly expanded the granularity of source data required to meet these various needs.

Perhaps the most comprehensive exposition of these emerging user requirements is that set out in Chapter 5 of the IMF's Compilation Guide for Financial Soundness Indicators. As with the Canadian papers, this begins by examining the level of consolidation within reported source data (legal entity or group based reporting) but then goes on to develop compilation concepts for cross border consolidation (to cover foreign subsidiaries and branches) based on the residency of control - domestic or foreign - of domestically incorporated enterprises and a separate and broader consolidation concept where the sector is defined by the population of enterprises in a defined industrial classification (banks in the FSI example) plus the non bank subsidiaries of this core group. While some form of analytical case can be presented for each of these various consolidation approaches (five or more), the source data requirements for some of the counterparty detail are unrealistic for some measures taken separately, and the building blocks to permit compilation in several alternative presentations would in any case be unmanageable.

Reconciling these competing user needs accordingly requires clearer understanding of the analytical case for their construction and the relative priorities to be placed on each. While SNA Rev1 will rightly focus on requirements for macroeconomic rather than macro prudential analysis, it should nevertheless acknowledge the case for these alternative presentations by offering a fuller articulation of the user case for consolidation within the SNA financial account and Balance sheet framework.

Cost Benefit issues

The case for pushing ahead with the development of alternative measures for macroeconomic (SNA) purposes has therefore to be weighed against the claims of other users seeking data based on alternative consolidation models. But it has also to be weighed against the expected compliance burden on reporters. As already noted, the information requirements for full consolidation of defined sectors can be considerable and will be greatly complicated where an additional subsectoral analysis is required. In this context, any changes made to the institutional classification of SNA Rev1 (such as those under consideration for Other Financial Corporations) will carry implications for the counterparty data requirements needed to effect consolidation within the rest of the financial corporations sector.

Hybrid Presentations

Such considerations encourage the use of estimation techniques and the use of approximation. But the evidence suggests that this often results in data presentations which are neither fully consolidated nor unconsolidated. Data in such hybrid formats - for example where partially consolidated source information are then aggregated - are of uncertain analytical value and may be judged less useful than a pure unconsolidated presentation. Moreover, hybrid approaches, which will differ in their detail between countries, must reduce the value of cross country analysis. Nevertheless, hybrid compilation models are the reality for many/most countries and probably best describe systems classified as unconsolidated just as much as those with a "consolidated" label.

Some Conclusions

The Canadian papers recognise the value of consolidated presentations (particularly for core sectors) but recommend that the SNA93 principle that in general the accounts of the system are not consolidated, be carried through into SNA Rev1. The UK supports this position which is in line with the ONS decision to give primacy to the unconsolidated presentation with a longer term development of a supplementary consolidated presentation. Promotion of consolidated accounts for key sectors (recommendation 2 in the first paper) offers a valuable step progression toward a more fully articulated framework. The new SNA text might assist in this and the EDG could play a role here - a paper from a country already preparing consolidated and unconsolidated accounts could be of particular value. On the other hand, the paper's recommendation on institutional units - specifically the proposed flexibility to report data from complex legal entities - raises some concerns. Where the ultimate aim is the preparation of a fully consolidated account, such an approach would eliminate an element of the compilation process. But, as general practice, we consider that the legal entity basis is to be preferred and may indeed carry lower compliance costs.

United Kingdom (Stuart Brown, U.K. Office for National Statistics)

In our annual Blue Book national accounts publication we describe all Financial Account and Balance Sheet Account figures by sector as unconsolidated, although we don't explain the term in the notes. We aim to collect data for a domestic group of companies from the group headquarters. We ask for these data to be consolidated within the group, although I don't think this aspect is included in our validation or checking processes. If the head office is a financial special purpose enterprise owning a PNFC group of companies

separate data are collected on a sector basis. Data on corporations are therefore consolidated to some extent within company groups but not across those groups, and not across unrelated corporations. Household and NPISH data are collected broadly on an unconsolidated basis where applicable. Estimates derived by imputation or residual would tend to be consolidated. In general we do collect sufficiently detailed data to make a reasonable attempt at consolidating our figures within sector and subsectors, but for the time being our systems and resource constraints simply do not allow such further analyses.

Statistics for the government sector are different. These are generally on a consolidated basis (even though the tables describe them as unconsolidated), and some tables may give sufficient breakdowns for users to impute consolidated figures. The only table in the Blue Book identified as consolidated shows an analysis of outlays by classification of function of government (COFOG). Again we don't explain what we mean by the term. This table is a European requirement.

We hope that we would be able to do more consolidation analyses by sector and subsector when the whole national accounts compilation system has been re-engineered and is based on modernised data storage facilities for all ONS data. This is still two years away at least, and further work would then depend on the availability of resources. There is no prospect of making any progress in the short term.

We do not have much discussion with our domestic national accounts users about consolidated statistics in the Financial and Balance Sheet Accounts. I am not aware of pressure from them to purify our sector statistics into unconsolidated and/or consolidated format. I doubt if they think very much about it, but that may be because we don't raise it with them. It would be useful to have clearer descriptions of the user needs for both types of data within the national accounts framework. What economic or monetary policies depend on each type of statistics? This might give an indication of the extent to which the mixed figures that many countries probably compile may be impeding policy making. Chris Wright pointed out that the recent Financial Soundness Indicators Compilation Guide puts the emphasis on consolidated data for the FSIs of all sectors. It would be helpful to spell out why macro-prudential analysis requires consolidated data but macro-economic analysis primarily needs (or can make do with) unconsolidated data.

Are we aware of an OECD country that claims to compile good quality unconsolidated and consolidated sector statistics separately? If so I think it would be very helpful to ask them if they could put together a case study. It would describe the data they collect, the reporting units and how their processing systems carry out the consolidation. It would also show the difference between the two sets of figures for each sector.

I think it would be helpful to underpin all this by stating some clear definitions of all the terms in the papers, maybe with some simply worked examples for the Financial and Balance Sheet Accounts. I do support the Canadian comment on the SNA93 definition of consolidation: "it could be argued that the definition stops somewhat short of a clear one".

Generally speaking, we accept the recommendations in both papers. They recognise current practice and try to accommodate it rather than trying to get countries signed up to something unrealistic for them. And I agree it's too late to introduce the issue for the current revision to SNA. Maybe the SNA Recommendation 4 could emphasise that possible consolidation of domestic legal entities of a complex corporation is for practical purposes rather than conceptual - if a country believes it is better to collect data from separate units, then fine.

Switzerland (Juerg Baerlocher, Swiss National Bank)

Swiss financial accounts were published for the first time in November 2005. So far, only data for stocks are available. Compared with the elaborate Canadian data collection system, the Swiss system is

rather simple: Balance sheet data are the primary source for the central bank, commercial banks, pension funds and general government only. For the other sectors, the main data sources are the sectoral classification of bank balance sheets, securities survey statistics, insurance statistics, and statistics on the international investment position. A detailed description of data sources is provided in 'Swiss Financial Accounts' (www.snb.ch, Publications). Data were sent to the OECD as 'non-consolidated' even though the extensive use of counterparty information implies that quite a few positions are available on a consolidated basis only. It is planned to send 'consolidated' data for financial corporations and general government to the OECD by the end of this year.

My comments on consolidation are general and pragmatic. I agree with the Canadian paper that the OECD database should be limited to the data users need most and that countries can provide in sufficient quality. I suggest considering limiting 'consolidated' data to financial corporations and general government, where consolidation matters most. With regard to the use of estimates, I have fewer reservations than expressed in the Canadian paper. I understand the concern regarding consolidated data being less accurate if they are based on estimates. However, data users may still find them useful. Would we be less concerned if certain lower quality data were specially marked, e.g. as 'OECD estimates'? Regarding non-financial corporations and in particular regarding households, I am not convinced that two sets of data are useful for data users. OECD should at least check whether 'non-consolidated' and 'consolidated' data of EU countries sent to Eurostat are really substantially different before they are entered into the OECD database.

I think that comprehensive methodological notes that are easily accessible should have high priority. Problems in 'non-consolidated' and 'consolidated' data should be treated with equal emphasis. Ideally, data users would find the following information:

- Which transactions/positions are not included in 'non-consolidated' data (e.g. because only counterparty information is available or because statistical units may be enterprise groups)
- Which transactions/positions are eliminated in 'consolidated' data and which are not eliminated due to lack of information
- How transactions/positions are eliminated (data sources, estimation methods)

In addition to my earlier comments suggesting that the OECD database should be less extensive, I also have a suggestion for broadening it, namely by including counterparty sector information. Such data is very relevant for data users. There are only a few countries which will be able to provide (almost) full counterparty sector information. However, in most countries at least some counterparty sector information is available, e.g. more or less complete counterparty information for deposits and loans of monetary financial institutions or a distinction between domestic and foreign counterparties for other items. As a first step, OECD could make an inventory of the counterparty information available in member countries.

IRELAND (John O'Hagan, CSO)

This paper has been written mainly against the background of the Statistics Canada paper(s), but also with the benefit of having seen the contributions to the EDG from US (Susan McIntosh), UK (Chris Wright and Stuart Brown) and Switzerland (Juerg Baerlocher). We welcome and support the idea that a comprehensive study needs to be undertaken to determine the differing uses to which consolidated and non-consolidated results are or could be put. Since CSO Ireland is very inexperienced in the compilation of financial accounts, and even less familiar with their day-to-day use by various classes of user, our comments are essentially confined to a description of our experiences to date from a practical perspective.

Financial accounts for Ireland

Ireland has started to publish financial accounts results only very recently (late September 2006). The first published results are limited to balance sheets, for 2001 to 2004, and only for the seven high-level financial instruments. Draft balance sheet results for 2005, and transactions results for 2002 to 2005, have been sent to Eurostat and are currently being checked and prepared for publication.

We describe these results as non-consolidated, and supplement them with alternative results for S13 (general government) on a consolidated basis. The latter set are compiled in close conjunction with the returns made to Eurostat in the context of the Excessive Deficit Procedure (EDP) of the European Union (which differ to some extent in scope and valuation from the ESA/SNA results).

CSO experience with consolidation

With the exception of S13 we have not to date attempted to compile formal consolidated results. In common with some other countries, we would have to acknowledge that in practice our so-called non-consolidated results do in fact involve some degree of consolidation, and our label is therefore somewhat misleading. We cannot readily quantify the extent of implicit consolidation in our results. It is essentially a function of our data collection methodology. On close examination, it might turn out that our results are in fact closer to the consolidated end of the continuum.

Some elements are compiled from direct surveys by the CSO. This approach is used for companies that are relevant for balance of payments purposes, including in particular inward and outward direct investment enterprises and other non-financial and non-bank financial companies that have significant foreign assets and/or liabilities. Considerable weight is given to respondents' own preferences in choosing what element of domestic consolidation to employ in these returns. The outcome is that in many (but not all) cases, the surveyed unit is the domestically consolidated enterprise group (occasionally even indistinguishably combining financial and non-financial entities). De-consolidating such returns to permit compilation of fully non-consolidated results is not currently on our agenda, and is unlikely to be seen as high priority.

On the other hand, consolidating the results for this group of entities may have only a minor effect on the results. The very open nature of the Irish economy, and the very significant level of international non-bank financial activity (mutual funds, securitisation vehicles, other forms of non-bank asset financing) results in this block of companies accounting for a very high proportion of total balances in the system. These companies tend to have a low proportion of their positions and transactions vis-à-vis domestic companies, affiliated or otherwise, and even less so with those in their own sector, and consolidation is thought likely to have a relatively minor effect.

Elements that are assembled from administrative returns, on the other hand, are much more likely to be based on the individual legal entity. This is true in particular of banks and insurance companies (based on the regulatory and statistical returns to the Central Bank and Financial Services Authority of Ireland, the main financial regulator) and of indigenous non-financial and non-bank non-insurance financial companies (based in general on annual business accounts filed with the general business accounts regulator (the Companies Registration Office) or with the tax authorities in support of the annual corporation tax return. For the banks and insurance companies, the counterparty analysis reported permits relatively straightforward preparation of consolidated accounts (although this is at present not carried through to any final published tables). For the others, however, allocation to counterparties is at best a statistical estimate, derived in the course of compiling and balancing the overall accounts.

For the household and NPISH sector, for which results are estimated primarily on the basis of counterpart information, the result is of course essentially already a consolidated one. In particular, unincorporated businesses are included in S14 essentially on the basis of counterpart information taken from or estimated from the results or returns for other sectors. As such, positions and transactions between unincorporated businesses, which in practice may be quite significant, albeit mainly in the instrument AF7, are in practice probably largely omitted from the system.

Can CSO compile consolidated results?

We are not yet sure that, even mechanically, it will be possible to compile fully consolidated results. Our present compilation procedure does involve the setting up of an internal full who-to-whom matrix for each instrument, with most cells represented by two separate estimates, more or less independent, drawn from data collected from the originating sector and the counterpart sector. The strategy currently being considered for consolidation is to force (by judgement if necessary) equality between the pairs of entries for each cell on the diagonals, and then to eliminate these balanced cells from the matrix. It is probably a matter of statistical judgement whether the level of diversity between the original “independent” estimates for these diagonal cells is too great to permit any confidence to be placed in the results. We are probably still some way from being able to make these judgements with confidence for most of the cells, with the main exception (for most instruments) of the S122 cell. When, as we must shortly do, we increase the depth of our system by moving from a seven-instrument compilation to the full detailed ESA/SNA instrument breakdown, the resulting increased complexity may push this task even further into the future.

CSO’s views on the recommendations to date of the Statistics Canada papers

Recommendations in the “SNA” paper

Recommendation 1: No view

Recommendation 2: Agree generally. Agnostic about the value of a consolidated S2 sector.

Recommendation 3: Agree

Recommendation 4: Agree. This is an important practical matter. Allowing flexibility of the sort proposed is probably unwelcome to analysts but is a recognition of a practical problem facing compilers.

Recommendation 5: Agree

Recommendations in the “OECD” paper

Recommendation 1: Agree

Recommendation 2: Agree

Recommendation 3: Agree

Recommendation 4: Not fully considered yet.

Recommendation 5: Agree.

APPENDIX: Recommendations from the Canadian EDG Papers

Consolidation in of Financial Account and Balance Sheet Account data in OECD Databases

Recommendation 1

That the current OECD initiative with respect to understanding consolidation practices in OECD countries continue, as a means to assess the feasibility of submitting both unconsolidated and consolidated **FA** and **BSA** data to the OECD. The results of this exercise could also serve as an important part of the OECD countries' methodological notes related to the OECD **FA** and **BSA** databases.

Recommendation 2

That the discussion on intra-sector consolidation be extended to include the treatment of complex enterprises in the various countries' **FA** and **BSA** databases.

Recommendation 3

That the effort to understand consolidation practices in **FA** and **BSA** be extended incorporate the consolidated data requirements of related datasets – especially with respect to the financial accounts at Eurostat and the IMF-MFS data. In particular, it may be useful to develop a better understanding of the policy/analytic need for fully consolidated **FA** and **BSA** data.

Recommendation 4

That the current OECD requirement for both unconsolidated and consolidated **FA** and **BSA** data be re-considered by the WPFS, given that some countries may find it difficult, burdensome or impossible to meet the current OECD demands; and, given that the labels “unconsolidated” and “consolidated” may not be accurate/useful in the case(s) of partially consolidated sub-sector data for some countries. In addition, some countries may have concerns about the perception of lack of compliance with the OECD requirements, especially if these same countries are largely consistent with SNA93.

One compromise proposal is that the burden of reporting to the OECD be reduced by returning to a one database submission for both **FA** and **BSA**, consistent with the published data of most countries. Sub-sector data would largely be unconsolidated, but would specifically reflect the data collection practices in the various countries. Sector data would be submitted on both a combined and on a consolidated basis, with the latter being voluntary. Most countries would be in a position to submit total government sector data on both a combined and consolidated basis, and many countries could submit at least partially consolidated depository corporations' sector. The level of country consolidated **FA** and **BSA** detail would vary, with likely more consistency across the European member countries. European countries, adhering to the Eurostat compilation practices, could continue to submit both non-consolidated and consolidated data. For non-European countries, the non-consolidated consolidated distinction would largely become reference for generally classifying their **FA** and **BSA** data.

Recommendation 5

That the WPFS plan to make a substantial contribution to the next round of revisions to SNA, where aspects income (including consolidation).

Consolidation of Financial data in SNA

Recommendation 1

It is proposed that the SNA93 principle that in general the accounts of the system are not consolidated stand. This underlines the primary roles of the **FA** and **BSA** in the overall core system of accounts.

Recommendation 2

It is proposed to re-emphasize in a re-draft of SNA93 that for certain types of analysis (e.g., government sector deficit/debt that consolidated sector accounts may be more appropriate. This would strengthen the link of the core accounts with the new SNA93 government-public sector chapter, and by extension with GFSM. It will be more difficult to tie into the SNA93-based MFSM, which requires consolidation to the point of having a broad consolidated financial sector; however, it can be argued that MFSM is an extension of SNA93 with respect to consolidation requirements.

Recommendation 3

It is proposed that the SNA93 general position against netting of financial instruments be retained. However, netting as an extension/approximation to consolidation could be allowed as part of specific types of analysis related to specific uses of consolidated data.

Recommendation 4

With respect to the definition for institutional units, it is proposed that the current SNA93 definition be retained but clarified with respect to the treatment of complex corporations. The current interpretation of SNA93 is that the relevant institutional unit for corporations is the legal entity corporation. It is proposed that this be broadened to indicate that an institutional unit could also be represented by a consolidation of related legal entity corporations. This would insert some flexibility into the framework, while retaining the original concept and reflecting the reality in many statistical agencies. This does not imply that a new statistical unit level need be classified in SNA93.

Recommendation 5

Further debate on consolidated enterprises could be deferred to the next round of revisions to SNA, where aspects of income will be a major review item.