

**TERMS OF REFERENCE FOR A TASK FORCE
ON FINANCIAL INTERMEDIATION SERVICES INDIRECTLY MEASURED (FISIM)**

I. Background

1. It has been long recognized, since at least the 1953 version of the System of National Accounts (SNA),¹ that the current price value of financial services has a significant indirectly measured component, whose value is covered wholly or in part in the spread between financial institutions' return on financial assets and expense on financial liabilities. Measuring the economy's output and use of FISIM has been the subject of refinements in every revision of the SNA since 1968. FISIM again was discussed during the preparation of the *System of National Accounts 2008* (2008 SNA), under Update issue No. 6a Financial Services. FISIM also has been discussed in the context of the *European System of Accounts* (ESA) Revision. The 2008 SNA FISIM recommendations are in Chapter 6, paragraphs 6.163-6.166.² The revised ESA will address FISIM in Chapter 14.

The 2008 SNA observes the following concerning the nature of financial services (bold added):

4.98 . . . The production of financial services is the result of **financial intermediation, financial risk management, liquidity transformation or auxiliary financial activities**. . . .

This is consistent with the conceptual views of the Financial Services Task Force that delivered its report in 2003, emphasizing the risk management and liquidity transformation, in addition to financial intermediation, components of financial services output. However, there is a broad international consensus that aspects of the international recommendations on FISIM should be clarified or further investigated. These are

- (1) How the composition of the services that FISIM covers—particularly risk management and liquidity transformation—affects the selection of the reference rate and the price and volume breakdown of FISIM,
- (2) The financial instrument and unit scope of FISIM, and
- (3) The connection between the recommendations on implementation of FISIM and the definition of income.

On aspect (1), there is a short-term need to clarify how the existing 2008 SNA text should be understood and applied in national accounts compilation. Consideration of aspect (2) reflects a medium-term need for answers to research questions concerning how the 2008 SNA handles the role of financial capital in production, in the context of the analysis and recommendations of, for example, the OECD manual *Measuring*

¹ See 1953 SNA, Chapter V, Section 2, p. 32, in the paragraph on financial intermediaries.

² The revised ESA will address FISIM in Chapter 14.

Capital. Aspect (3) concerns, among other things, how the findings under (1) and (2) shed light on another 2008 SNA research agenda topic, the definition of income.³

2. The main results from the work on the two national accounts projects (SNA and ESA) are the following:
 - 2.1. The AEG recommendation 6a on financial services for SNA 2008 states:
 - "- FISIM should be calculated on loans and deposits only. All loans and deposits provided by financial intermediaries will be included, not just those made from intermediated funds;
 - A reference rate is to be used in determining the level of services on loans and deposits separately."
 - 2.2. SNA 2008 paragraph 6.166 states:

"The reference rate to be used in the calculation of SNA interest is a rate between bank interest rates on deposits and loans. However, because there is no necessary equality between the level of loans and deposits, it cannot be calculated as a simple average of the rates on loans or deposits. The reference rate should contain no service element and reflect the risk and maturity structure of deposits and loans. The rate prevailing for inter-bank borrowing and lending may be a suitable choice as a reference rate. However, different reference rates may be needed for each currency in which loans and deposits are denominated, especially when a non-resident financial institution is involved."
 - 2.4. Also the SNA 2008 Research Agenda includes the problem of calculation of FISIM (Annex 4 paragraph 33):

"The SNA recommends that FISIM should be calculated with respect to a reference rate that contains no service element and reflects the risk and maturity structure of deposits and loans. Different reference rates may be needed for domestic and foreign financial institutions. The assumption behind the FISIM approach is that it is the service element, and not the interest flows, that reflect varying degrees of risk, with riskier clients paying a higher service charge. This assumption has been queried and is being investigated."
 - 2.5. During the ESA revision, the current ESA method of calculating and allocating FISIM was supported by most experts in Eurostat's National Accounts Working Group. However, it was considered that the issues of reference rates and of risks should be further investigated by a Task Force.

II. Main issues to be further investigated

3. Paragraph 1 raises an issue for clarification and two research issues on the FISIM. The task force on FISIM will only deal with the clarification issue. In particular, the task force will focus on determining at most one reference rate per currency for the FISIM calculation following language in the 2008 SNA (6.163-6.169) and Balance of Payments and International Investment Position Manual (10.129). The research issues will be dealt with at a later stage. The report of the OECD Financial Services Task Force (www.oecd.org/dataoecd/9/60/24332238.doc) considered Risk management and Liquidity transformation to be the main components of financial service output,

³ The 2008 SNA includes, in Annex 4, clarification of the definition of income as the first research topic (paragraph A4.23) under a category of entitled "The Concept of Income." The FISIM topic that is the focus of this Task Force is the seventh research item (paragraph A4.33) under the same "Concept of Income" heading.

particularly indirectly measured output (FISIM). Two overarching questions of clarification of the 2008 SNA text have arisen under these headings that are related to risk premia (that could include currency risk premia) and maturity. They call for further analysis (and perhaps a test period). For this purpose four clarification questions are posed to the FISIM task force:

- 3.1. **First clarification question (Risk management):** *How should financial institutions' risk management/mitigation activities be characterized and reflected in FISIM?*

Background: At least two views have formed on this question. The first is that risk premia should be included in FISIM to cover costly risk mitigation activity and/or purchased insurance against specified risks. The second is that risk premia should be excised from FISIM because they do not represent payments for services but are only distributive flows.

The first view interprets the language of the 2008 SNA as referring to a reference rate that is not matched to the specific risk profiles of the instruments on which FISIM is calculated. This allows instrument risk profiles to affect the current price value of output of financial services (and generally to affect the *relative* prices of the services associated with those instruments). The second view is characterized in terms of matching reference rates to loan assets by individual asset risk profile, effectively cancelling the risk premia in loan rates with the risk premia in the risk-matched reference rates. An example of this is matching commercial and industrial loan rates with reference rates from commercial paper (a type of SNA debt security that, for a given commercial borrower, should have a similar risk profile to a loan).

Regarding currency of denomination, part of the interest rate differential across currencies reflects exchange rate risk, other things equal. The reflection of exchange rate risk differentials in FISIM appears to be analogous to, for example, treatment of the default and other risks that earn loan interest premia/discounts regardless of the currency of denomination. If currency risk premia compensate resources that are committed to risk mitigation, then reference rates specific to exchange rate risk profiles also should not be matched to individual assets. On the other hand, if currency risk premia are distributional flows only, this matching should occur. In the first case, currency/exchange rate risk is reflected in FISIM, while in the second it is not.

- 3.2. **Second clarification question (Liquidity transformation):** *Transforming short-term deposits into long-term loans is inherent to financial intermediation. How should this transformation element be represented in FISIM? Should the differences in maturities be reflected in FISIM calculations? If so, how?*

Background: Two views have formed on this question as well, again characterized by choice of reference rate.

The first view interprets the language of the 2008 SNA as referring to a reference rate that is not matched to the specific maturities of the instruments on which FISIM is calculated. This allows instrument maturity to affect the current price value of output of financial services (and generally to affect the *relative* prices of the services associated with those instruments). The second view has characterized its position in terms of reference rates matched to deposit and loan assets by maturity, thus by implication excluding maturity premia from FISIM.

Since deposit-taking corporations tend to take loan positions that are longer than their deposit positions, the issue also can be characterized as whether FISIM should or should not cover the cost of hedging the inherent term risk of these positions.

3.3 **Third clarification question:** : *How can FISIM be made consistent in international trade?*

Simply put, exports of FISIM from the resident of one country should equal the imports of FISIM received by the resident of another country and vice versa, regardless of the currency unit selected to show these flows. How does the calculation of FISIM, via conversion between domestic and foreign currency, and via selection of reference rate, affect this balance? This issue may relate to the idea of allowing different reference rates by currency of denomination noted under clarification question (1), but it needs to be explained and placed in the context of the answers to the other clarification questions.⁴

3.4 **Fourth clarification question:** *What are the implications for the price and volume measures of FISIM that follow from the clarification of the issues raised above?*

III. Way forward

5. The calculation and allocation of FISIM have an impact on major national accounts aggregates, such as Gross Domestic Product and Gross National Income. The ISWGNA considers that work on FISIM at international level is needed in order to ensure comparability of estimates between countries.
6. This work would be carried out by an international Task Force comprising representatives of ISWGNA agencies (Eurostat, IMF, OECD, UN and World Bank), national statistical offices, central banks and other institutions with expertise and interest in indirectly measured financial services in the national accounts.
7. The Task Force would report to the ISWGNA
8. The formation of Task Force on FISIM also provides an opportunity to capitalise and consider related issues, concerning financial services more broadly, that some national institutions have raised in discussions with ISWGNA members.
9. One such issue relates to the bid-ask spread that financial intermediaries obtain in the course of market trading; which is typically recorded as a holding gain in the SNA. However one could conceptually argue that the spread represents a margin that reflects payment for a service, and that, as such, the accounts currently underestimate this activity.
10. The ISWGNA have therefore concluded that this issue should also form part of the research agenda that should be considered by participants of the FISIM Task Force.
11. The first meeting of the Task Force could take place in Washington on the 14-15 February and the second meeting in July 2011, reporting its recommendations on the resolution of the **clarification questions** for ISWGNA consideration in the last half of 2011. Any progress made in considering the bid-spread issue could also be made at that time but there is scope for recommendations on this particular issue to come at a later date; either via electronic discussion through Task Force members or a third meeting of the Task Force, that could be organised around the time of the 2011 OECD National Accounts Working Party meeting.

⁴ It would be helpful if the Task Force could recommend that national accounts compilers provide institutional sector breakdowns of FISIM, at least regarding flows between residents of an economic territory and the rest of the world, in the interest of improving the coherence between the national accounts and balance of payments statistics, distinguishing in particular exports and imports of FISIM.