MEETING OF THE TASK FORCE ON
FINANCIAL INTERMEDIATION SERVICES INDIRECTLY MEASURED (FISIM)

Hosted by the IMF

March 3 & 4, 2011

IMF Headquarters 1 (HQ1)
Room 2-530, 700 – 19th Street N.W., Washington D.C.

Treatment of liquidity transformation in FISIM

Herman Smith, Chief, National Accounts Section, United Nations
Treatment of liquidity transformation in FISIM

Meeting of the ISWGNA Task Force on FISIM

03 to 4 March 2011, Washington DC, USA
Treatment of liquidity transformation in FISIM

- Transforming short-term deposits into long-term loans is inherent to financial intermediation and provides "matching benefits" to financial intermediaries.

- Should this transformation element be included into FISIM output or should the transformation element be excluded from FISIM output?
Treatment of liquidity transformation in FISIM

- 1st view – Include transformation element

- **Natural rate of capital.**
  - There is something like a “pure” cost of borrowing funds, represented by a single risk free reference rate.

- **Risk management is a productive activity.**
  - Not the lending and borrowing itself is a productive activity, but the process of intermediation of funds.
  - The risk premium can be considered as remuneration for the (financial) risk management, and is therefore part of the bank output.

- **Liquidity provision is a service, requiring labour and capital inputs.**
  - The rationale for introducing maturity-matched reference rates is based on an irrelevant comparison of characteristics of loans and deposits with credit market instruments.
Treatment of liquidity transformation in FISIM

- 2nd view – Exclude transformation element

- Avoid counter intuitive results
  - GFC brought about high interest rates resulting in a significant increase of output of financial intermediaries, which does not seem to be related to increased services. Banks should not be considered as producing more services merely by taking more risk.

- The term premium and the credit default risk is not part of the output of financial services.
  - The term premium reflects the assumptions about future interest rates but is also a compensation of the investors for having their money tied up for a longer period, including the added risk of greater price uncertainty.

- A productive service only requires the input of capital and labour
  - Therefore FISIM output should not reflect the credit default risk and term premium.

- Changing nature of banking activities.
  - Banks do not anymore transform maturities as they rather enter into interest rate swaps to hedge their maturity risk. This triggers the argumentation that the interest rate swap spread should be deducted from the FISIM output of the banks.
Treatment of liquidity transformation in FISIM

- **1st view** – Include transformation element in FISIM
  - Use reference rate not matched to specific maturities of loans/deposits

- **2nd view** – Exclude transformation element from FISIM
  - Use maturity-matched reference rates
Thank you