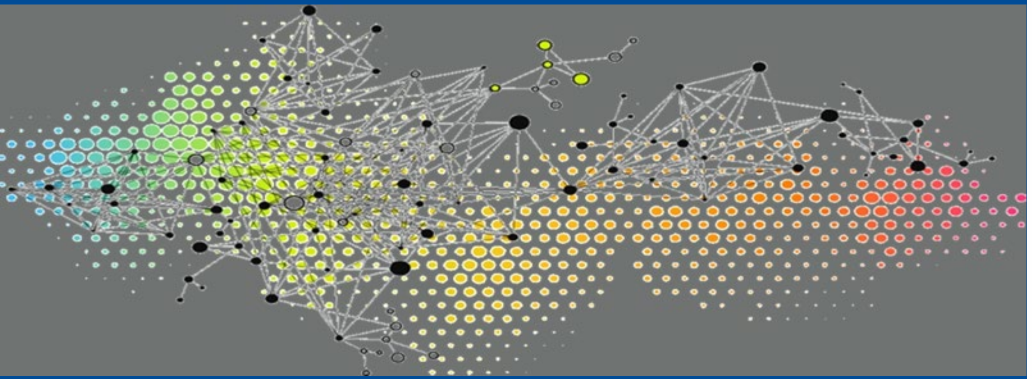

STATISTICS

INTER SECRETARIAT WORKING GROUP ON NATIONAL ACCOUNTS

D.2 Valuation of Unlisted Equity (BOPCOM 21/15)

Joint (Virtual) Thirty-Seventh Meeting of the IMF Committee on Balance of Payments Statistics and Seventeenth Meeting of the Advisory Expert Group on National Accounts

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Acknowledgement

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Background

The current methodological standards posit that market value is the recommended basis for the valuation of equity.

- Shares and other equity can be readily valued at their current prices when they are regularly traded. If financial instruments are not or infrequently traded, a fair value should be estimated.

- Two instruments are included under the concept of unlisted equity: unlisted shares (F512) and other equity (F519). In the context of external sector statistics (ESS), the valuation issue primarily affects unlisted equity in direct investment (DI).

- The current manuals, including *BPM6*, *2008 SNA,* and *ESA 2010*, recommend six different methods for valuing such equity: recent transaction price, net asset value, present value or price to earnings ratios, market capitalization ratios, own funds at book value (OFBV) and apportioning global value.

Issues

- For the economy, the approach to measuring the current/market value of unlisted equity may differ across institutional sectors and between the asset and liability sides. As such, national accounts (NA) compilers want to use as consistent an approach as possible, to produce accurate institutional sector equity asset and liability estimates taking into consideration inherent differences amongst the sectors.
- In external sector statistics, it has been observed that differences in country practices for valuing unlisted equity in DI make it difficult to achieve international comparability, resulting in bilateral asymmetries. Although different valuation techniques will produce different estimates, they may provide more accurate and consistent market value equity estimates by institutional sector.
- Own Funds at Book Value (OFBV) is reported as the method used by the largest number of countries for ESS.
- In some countries, stock market indices and capitalization ratios are used to derive market values of unlisted equity.

Issues

- OFBV can diverge from market values because the International Accounting Standards (IAS) prohibit the recognition of many types of intangible assets and take a conservative view of the value of assets and a pessimistic view of the value of liabilities.
- The methods, as currently presented in the manuals, are not ranked according to preference. No method, so far, has been identified as clearly better than the rest. Hence, there are advantages and disadvantages associated with each of the methods.
- There are some factors that can significantly affect the valuation of unlisted equity that must be considered, namely liquidity, control premium, negative equity values, and treatment of provisions, the last two being addressed in the note.

A decision tree has been proposed with a view to facilitating decision-making for the selection of appropriate valuation methods.

Outcomes

Outcomes

Issue 1: Identifying Preferred Valuation Methods

The following options were identified:

- *Option 1.1: Adopt the proposed use of the methods based on the decision tree presented in Annex VI and include it in the updated BPM and SNA.*
- *Option 1.2: Adopt the methods recommended in the* ESA 2010 *and Final Production Flows and Stocks in the SNA as preferred methods.*
- *Option 1.3: Cease recommending some of the proposed methods, those ranked lower or applicable only in very specific cases as shown in the decision tree, in both the updated BPM and SNA.*
- *Option 1.4: Leave some of the proposed methods as part of the methodological guidance but clearly limit their use to specific cases in the updated BPM and SNA.*
- *Option 1.5: No changes to the manuals.*

The DITT acknowledged that the preferred methods along with the proposed decision tree should both be introduced in the updates, as they are complementary.

Outcomes (cont.)

Issue 2: Treatment of Negative Equity

Two options are proposed:

- *Option 2.1: Clarify the treatment of negative equity in the current BPM and SNA framework covering both limited/unlimited liability in a separate clarification note.*
- *Option 2.2: No changes to the manuals.*

Issue 3: Treatment of Provisions

Two options are proposed:

- *Option 3.1: review the treatment of accounting provisions, including loan loss provisions, in the particular case of the valuation of unlisted equity under OFBV.*
- *Option 3.2: No changes to the manuals.*

The DITT agreed that more explicit guidance is needed on negative equity and treatment of provisions in both the *BPM6* and the *2008 SNA*.

Results from the Global Consultation Questionnaire

Results from the Global Questionnaire

Sixty-one respondents from 55 economies participated in the global consultation of the Guidance Note (GN) D.2. 30 respondents provided responses for Balance of Payments (BOP) followed by coordinated responses for BOP and national accounts (NA) (20 respondents) and for NA only (11 respondents). Below are some of the questions asked from the questionnaire:

- 44 respondents stated that the compilation approach is consistent across Balance of Payments and National Accounts.
- Of those replying on behalf of the NA or both NA and BOP, almost all compile institutional sector accounts (ISAs) and balance sheets (BS).
  - Almost half of them indicated that the share of unlisted equity in total financial assets is greater than 20 percent while just over one-quarter estimated that unlisted equity is greater than 20 percent of household financial assets .
  - The majority indicated that their ISAs and BS are on a market value basis and that the valuation method depends on the institutional sector and data availability.

Results from the Global Questionnaire

- Only 19 respondents compile **Gross Capital Formation** and stock estimates of **Intellectual Property Products (IPP)**. Most of these economies do not attempt to derive market valuation of Own Funds at Book.
- **The top three preferred methods** are OFBV (45 respondents), Recent Transaction Price (43 respondents) and Market Capitalization (28 respondents).
- **Of the valuation methods currently used by respondents,** 43 respondents use OFBV; 16 use Recent Transaction Price, and 13 use Market Capitalization Method-P/B
- 35 respondents considered helpful to reduce the current number of methods to value unlisted shares provided by the *2008 SNA* and the *BPM6*.
- 20 respondents said a compilation guide is needed and 15 indicated that workshops on the compilation of unlisted equity would be useful.

Results from the Global Questionnaire

Outcomes

- Issue 1 - Identifying preferred valuation methods
  - Adopting the decision tree (Option 1.1) was agreed or strongly agreed by 40 respondents, followed by (Option 1.2) the 3 principal methods from the Handbook of Financial Production Stocks and Flows and *ESA 2010* (by 35). There was less support to *cease* recommending some methods not widely used or applicable only in very specific cases.
- Issue 2 – Treatment of Negative Equity
  - Do you agree with the proposal of preparing a separate clarification note on the treatment of negative equity?
    - There was wide support of respondents that agreed with the need to prepare a separate clarification note
- Issue 3 – Treatment of Provisions
  - Do you think that it is necessary to clarify the impact of various types of provisions on the value of unlisted equity as discussed in the note?
    - There was broad support for additional clarification to be included in all manuals

Global Consultation: WGIIS Outcomes

- The most commonly used method to value unlisted equity by respondents was the **Own Funds at Book Value (OFBV).**
- A majority of respondents (13) was **in favor of adopting the proposed methods based on a decision tree** (Option 1.1). There was strong support (by 16 respondents) for the proposed decision tree, which was considered a practical tool to identify the best method to use based on available information. Most respondents (11) were in favor of including preferred methods and the decision tree in a complementary manner in the updated manuals. Yet a significant number of respondents (8) supported including only the preferred methods.
- **The OFBV, recent transaction price, and market capitalization were the top three preferred methods**, with the OFBV selected by 18 respondents, and the transaction price and market capitalization method selected by 11 respondents each.
- There was clear support (by 18 respondents) for including **more guidance** on some factors that might affect valuation of unlisted equity.
- Almost all respondents agree with the proposal to prepare **a separate clarification note on negative equity.**
- The majority of respondents believes **IOs assisting in implementing a system of information-sharing** among statisticians could promote homogeneity in the valuation of unlisted shares worldwide.

Questions for Discussion

Questions for Discussion

1) *Do the Committee and the AEG agree that cross country comparability within the ESS and consistency across institutional sectors within the SNA would be enhanced by identifying some methods as preferred? If so, what would be your preferred method(s)?*
2) *Do the Committee and the AEG think that it is necessary to incorporate guidelines on the issues raised in the note (negative equity, treatment of provisions, etc.)? If yes, where, whether in both the* BPM6 *and* 2008 SNA *or in the* BPM7 Compilation Guide*?*
3) *Do the Committee and the AEG agree with the proposal of preparing a separate clarification note on the treatment of negative equity?*
4) *Do the Committee and the AEG consider a system of information sharing across countries would promote homogeneity in the valuation of unlisted shares worldwide? If so, which preconditions must be met to implement the system and how could international organizations assist in the implementation?*

Thank You