Chris Wright
Senior Advisor
Monetary and Financial Statistics Division

BANK OF ENGLAND
Threadneedle Street
London
EC2R 8AH

Tel: 44 20 7601 4624
Fax: 44 20 7601 3334
E-mail: chris.*wright@bankofengland.co.uk*

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Mr Ivo Havinga
Chief of the Economic Statistics Branch
UNSD

Dear Ivo,

Bank of England (MFSD) response to IMF/UN on SNA (1993 Rev. 1) consultation.

We are pleased to have this opportunity of commenting on the UN's further consultation on the SNA (Rev 1) Vol1 text. The following suggestions are offered as clarifications rather than as disagreements on points of substance. Our comments mostly concern Chapter 4, but also cover Chapters 11, 12 and 13.

[1] Chapter 4

We are pleased that the Bank of England Statistics Division submission on the treatment of certain types of SPVs has been reflected in the drafting of this Chapter. In particular we support the revised wording of paras 4.54 to 4.61 which now makes clear that certain vehicle companies resident in the same territory as their parent should only be classified as separate institutional units if they satisfy the requirement for demonstrating independence from their parent. This is an important clarification.

In noting this new text, it is appropriate to consider whether other references in Chapter 4 to SPEs are consistent with it. We note that para. 4.108 includes '*(a) Financial corporations engaged in the securitisation of assets*', under the sub-sector heading '*5. Other financial intermediaries, except insurance companies and pension funds (ICPFs)*', and that para. 4.112 includes: '*(d) SPEs or conduits that qualify as institutional units and raise funds in open markets to be used by their parent corporation*', as part of the sub-sector '*7. Captive financial institution and money lenders*'. This would entail a three-way, at least, treatment for resident entities engaged in securitisation activities: as artificial subsidiaries; as other financial intermediaries, or as captives. It may be asked whether these treatments give rise to possible confusion.

With respect to the first and third of these treatments, the qualification in 4.112, '...*that qualify as institutional units*...', is important and helpful in that it refers to the primary criteria developed in 4.54 to 4.61.

With respect to the second treatment, the defining difference would be the criterion set out in para. 4.107, in which an entity is an OFI (except insurance companies and pension funds) if it engages '...*in transactions on the market*'. This would appear to exclude, for example, the case of SPEs whose financial assets consist solely of the securitised assets of their parent or related entities. By contra-distinction, our presumption would be that this category might include entities such as the government sponsored enterprises (Fannie Mae, etc.,) of the USA.

Therefore we would conclude that the drafting of this chapter in relation to, broadly, securitisation vehicles which are incorporated entities, is satisfactory and consistent.

We might, however, suggest consideration of one possible clarification with respect to the existence of partnership structures used for covered bond issues, such as the case of UK limited liability partnerships. These achieve much the same effect and have similar characteristics as SPEs used for securitisation as are discussed in 4.54 to 4.61, but formally they are not incorporated entities although they would be considered in the System as 'quasi-corporations'. It is possible that the drafting of 4.59 to 4.61, where 4.59 begins, '*A subsidiary corporation*...', might inadvertently serve to exclude covered bond LLPs from the scope of artificial subsidiaries. Moreover, in para 4.112 the inclusion of, '*(a) Units which are legal entities such as trusts, estates, agency accounts or brass plate companies*' as part of the sub-sector '*7 Captive financial institutions, […etc.]*' might be taken to include covered bond LLPs as institutional units of this kind.

A suggested clarification that would address this concern would be to insert: '*or quasi-corporation such as a partnership or trust*' into the first line of 4.59, so that this paragraph would now begin as follows:

> *A subsidiary corporation, or quasi-corporation such as a partnership or trust, wholly owned by a parent corporation, may be created to provide services to the parent corporation, or other corporations in the same group, in order to avoid taxes, to minimize liabilities in the event of bankruptcy, or to secure other technical advantages under the tax or corporation legislation in force in a particular country.*

[2] Chapter 4

One question might be how the proposed financial corporations sub-sectorisation would classify funded financial compensation schemes, such as statutory depositor protection or pension fund protection schemes, which may as part of their operation assume the assets and liabilities of failed entities. Were it not for their possible assumption of balance sheet risk, such entities might be expected to be classified under the '*captives*' heading.

[3] Chapter 4

We have reflected on how the new text would treat central clearing counterparties (CCPs). Broadly, we would view these entities as serving a market infrastructure purpose, and therefore should be classified as financial auxiliaries, even though they take ownership of matching positions in significant size in their relevant financial instruments. However, because these positions are precisely matched, and clear margin and collateral arrangements apply to CCP members, we would not consider that this function of a CCP would constitute financial intermediation as we understand the term. It is possible, however, that the drafting of 4.109, describing financial auxiliaries as: '*…not taking ownership of the financial assets and liabilities being transacted*' might be read as precluding this treatment.

If this concern is more widely held, then a possible remedy might be to insert in para 4.109 an additional example, namely:

'central clearing counterparties which maintain fully matched positions in certain financial assets and liabilities'.

[4] Chapter 11

11.28: says "... These two classes of assets are gold bullion and shares. Gold bullion is owned by monetary authorities and others subject to the monetary authorities' effective control and is held as a financial asset and as a component of foreign reserves. ..."

For clarity the first sentence should perhaps say "... gold bullion held by monetary authorities and shares." and the second sentence "Gold bullion is a financial asset (monetary gold) when it is owned by monetary authorities and others subject to the monetary authorities' effective control ...".

[5] Chapter 11

11.112 says: "An observable market price or an index for the underlying item is essential for calculating the value of any financial derivative. ... The risk embodied in a derivatives contract can be "traded" either by trading the contract itself, such as with options, or by creating a new contract that embodies risk characteristics that match, in a countervailing manner, those of the existing contract owned."

Strictly speaking the valuation of many credit derivatives does not depend on the availability of a market price for the underlying. In the second sentence it may also be helpful to add "some" before "options" to avoid the implication that options are always traded in secondary markets.

[6] Chapter 12

12.36 says: "Financial assets that are claims on other institutional units are created when the debtor accepts the obligation to make a payment, or payments, to the creditor in the future; they are extinguished when the debtor has fulfilled the obligation under the terms of the agreement. Monetary gold, however, cannot be created and extinguished in this way; hence, it enters and leaves the System through the other changes in the volume of assets account."

For clarity the second sentence should say "Monetary gold held in the form of bullion and allocated gold accounts ..." since unallocated gold accounts do follow the pattern described in the first sentence.

[7] Chapter 13

13.59 says: "Long-term securities should always be valued at their current prices on markets, whether they are bonds on which regular payments of interest are paid or deep-discounted or zero- coupon bonds on which little or no interest is paid."

The paragraph might usefully note the availability of "clean" and "dirty" prices on many such markets and the SNA requirement for dirty prices which include any interest accrued but not yet paid.

Finally, on the question of the title, we would see some merit in the "2008" formulation.

Kind regards

Chris Wright