

SECTORAL ANALYSIS OF BANKING STATISTICS A JOINT BANK OF ENGLAND/CSO STUDY

INTRODUCTION

The then Chancellor announced in May 1990 a series of 19 projects to improve the quality of economic statistics (1). One of these (project 13) was a study of potential inaccuracies in the sectorisation of bank deposits and lending. Such inaccuracies were thought to be potentially a major source of error in the sector financial accounts and of the resulting sector balancing items (the error between measurements based on the "real" economy and those based on the financial economy).

The project was carried out jointly by Ted Doggett of the CSO and Corinna Balfour of the Bank of England during the period October 1990 to April 1991. The following section of this article summarises the findings of this report as written in April 1991. A short paragraph after each recommendation (in italics) brings the reader up to date with action by the Bank of England and CSO to implement the recommendations of the report.

PROJECT 13 REPORT - APRIL 1991

Project 13 was set up to assess the likelihood and location of possible errors or biases in the allocation to national accounts sectors of financial flows and balances derived from banking statistics. The project centred round visits to the main UK offices of 16 selected banks representing a cross section of banking types.

The Bank of England has over the years undertaken a number of studies into the accuracy of banks' classification of accounts by sector. For example: an investigation into the sterling interbank difference in 1973 (2); lending to "other financial" and "other services" in 1985 (3); exercises on public corporations' bank borrowing (1984-85), transactions with local authorities (1988) and lending to central government (1988).

REVIEW OF INSTRUCTIONS GIVEN TO THE BANKS

Instructions to the banks for completion of the forms allocating accounts to economic sectors are given in "Banking Statistics Definitions" (the "Red Folder") (4). This includes a section on the classification of accounts and there is also a separate booklet on this subject, though this has not been re-issued since 1983. The "red folder" itself is kept up-to-date on a regular basis and statistical notices (up to ten a year) are issued to all reporting banks to inform them of current developments (such as privatisations).

The views of the banks as reported to the project team during visits were that the instructions were generally satisfactory, though there was a lack of clarity in certain areas. Many felt that more could be provided on classification and would welcome a re-issue of the separate booklet; problems of keeping the instructions up-to-date and of ensuring that the banks knew that they had the most recent version of any definitions were also mentioned.

About 250 responses to a special questionnaire on the usefulness of the "red folder" were received, with some banks sending in more than one answer. Nearly 70% of respondents rated the folder as "good" as regards general usefulness and a further 10% rated it as "excellent". Nevertheless many respondents felt the definitions were very hard to understand, especially for newcomers to the subject, and the majority felt ease of understanding only to be "fair". Some 70% of respondents felt that three additional features would be "very useful". These features were: an index; comprehensive lists for the classification of accounts; and more precise definitions of individual items.

VISITS TO BANKS DURING 1990/91

Visits to the banks convinced the team that banks generally make a good job of classifying accounts by economic sector. It is also evident that they put considerable resources into completing returns for the Bank of England and there are pressures from supervisors and regulators for them to get the figures correct. The Bank of England's checking procedures are also thorough and help to uncover further errors.

The greatest problems arise in the retail banks where the coding is done at branch level (some 15,000 in total), often by inexperienced junior staff. Here training by the central accounts area, good instructions and a user-friendly coding system can all help. It was, however, clear that the costs of making major changes to systems are huge, even for an overseas bank where the coding is all done centrally. UK branches of foreign banks tend to have to refer expenditure back to head office and Bank of England reporting may not feature high on the overall priorities of the bank.

Some banks have computer consistency checks, others do not. The branches have access to their own bank's version of the Bank of England Red Folder for guidance. Branches are usually told to refer queries up through the bank's hierarchy. Ultimately, if the query cannot be resolved within the bank, their central accounts area can ring the Bank of England. However, the impression given was that branches do not raise very many queries.

RECOMMENDATIONS AS AT APRIL 1991 (with April 1992 position shown in italics).

(a) Re-issue classification of accounts booklet

A new version of the separate classification booklet, together with regular updates, as a self-contained guide would be welcomed by banks, and the Bank of England has already started work on this. Production and updating of the booklet will be costly, especially if it is distributed widely throughout the banks' branch networks, though the cost will depend on the format agreed. Nonetheless, the team felt that this cost would be justified in terms of the use likely to be made of it.

The main part of the booklet would consist of an alphabetical list of the main companies/institutions together with their appropriate sectoral and industrial codes. This will be the primary source for coders to use and will mean that they will no longer need to look

through a series of lists by sector. The booklet will also need to contain guidance on how to treat difficult cases, such as the definitive classification to be agreed between the Bank of England and the CSO on how to treat financial arms of non-financial companies; public sector boundaries will also need to be set out clearly.

ACTION: The contents of the "red folder" have been revised to take into account changes to the statistical forms as a result of the current Banking Statistics Review (an article on this review will appear in a future edition of the Bank of England Bulletin). In addition, the Bank of England intend to re-issue the separate classification of accounts booklet during 1992, which will include some of the improvements proposed in the project 13 report. Further enhancements await a comprehensive rewrite to make the folder more user-friendly which will commence in conjunction with the British Bankers' Association later this year.

(b) Carry out further work on CDs and other transferable instruments issued by banks

Some further work should be done on the allocation of the residual amount of CDs where the sector of the holder is not known. The procedure would initially take the figures from the CSO Survey of Financial Assets and Liabilities of UK Industrial and Commercial Companies (an enlarged version of the former Company Liquidity Survey) and from other reporters for the first quarter of 1991. The intention would be to come up with a pro-rating of the revised residual element across all sectors; the question of personal sector holdings would also be investigated.

In addition, the Bank of England should do more work to establish whether any institutions other than those already covered are acting as custodians. If so, returns on holdings by overseas residents should be sought from them.

As regards other transferable instruments, the only area where substantial error may occur in the national accounts is over banks' (and building society) issues of paper of over one and not over five years' original maturity. The treatment of this needs to be re-considered by the CSO and the Bank of England.

ACTION: Initial improvements to the sectorisation of CDs and other short term commercial paper issued by banks (and building societies) were completed in time for the necessary adjustments to be made for the 1991 CSO Blue Book (5). A review of the methodology and assumptions is scheduled for the 1992 edition. Similar studies of other instruments are in progress within the CSO.

(c) Investigate the looking through question

The national accounts require deposits and loans to be classified by the economic sector of beneficial ownership. It was clear from the discussions with banks that they are not in a position in general to look through to the ultimate "owner" of accounts placed by agents (eg Local Authority money funds). The recommendation on the investigation of the inter-bank difference (see below) should shed some light on the extent to which agency funds are being misclassified as banks' funds.

The need however is for a pilot study into the financial activities of fund managers. This would enable the CSO to assess the scale of the problem caused by the banks' inability to look through the managers to their clients. It will also help to establish a strategy for covering the managed funds consistently and comprehensively in the financial accounts. The study will need to take account of

the information derived from returns collected under Chancellor's Initiative project 3 (Overseas services earnings). The study will need to distinguish between the managers' own funds (ie those that appear in their balance sheets) and those managed for others (that do not).

ACTION: It has been agreed that fund managers should be classified to the other financial institutions sector (as financial auxiliaries). The Bank of England investigated the scale of client bank accounts of fund managers, using details from copies of 1990 returns provided for supervisory purposes to IMRO. This did not identify the sector of the clients' funds and further work is still needed on this. Responsibility for this area of work has now transferred to the CSO.

(d) Investigate the domestic interbank difference

Although the stock of the interbank difference (£8bn in 1991) is not large in relation to the total stock of outstanding interbank business, the flow figures can be substantial. In the visits banks claimed that classification was not a problem, either in terms of knowing what a bank is or in terms of residence. However, the very existence of the difference suggests that classification problems of some kind must be occurring. This would feed through to the balancing items in the national accounts. The advantage of doing an exercise on the interbank difference is that it is a problem entirely related to one sector.

The growth of the interbank market since the last such study in 1973, and the number of banks now involved mean that it would not be economic to carry out a similar full-scale exercise now. The proposal would therefore be to do an investigation covering a sample of banks most active in the interbank market asking them for details of all their counterparties in the interbank market at a specified date. This information should initially reveal any gross errors of mis-classification and the next stage would be to investigate the remaining differences bilaterally. This second stage would reveal the reasons for the interbank differences and the scale and importance of the different factors involved.

ACTION: A sample survey of the interbank difference has been commissioned by the CSO and conducted by the British Bankers Association Statistical Unit in respect of October 1991. The survey results are currently being studied and a report will be published later this year.

(e) Investigate further the banks' classification of unincorporated businesses

Project 13 showed that some of the banks visited were classifying unincorporated businesses incorrectly. The Bank of England should conduct a more comprehensive survey of how banks classify this sector. The Bank and the CSO should then consider, in the light of the results of this inquiry, whether further work is required (possibly including a sample survey) to help quantify any bias in the statistics.

ACTION: An investigation into the problems of the classification of unincorporated businesses (which include non profit making bodies) has been conducted by the Bank of England. This follow-up study, based on existing returns, found that major difficulties were being experienced by a small number of retail banks. There was some evidence of inconsistencies and errors in returns from non-retail banks, which have been rectified. The retail banks concerned have been approached by the Bank of England and hope to improve their reporting and classification of accounts over the coming year. It does not now appear that a sample survey of accounts as envisaged by the project 13 report will be needed.

(f) A comprehensive sample survey of accounts at branch level should not be attempted.

There is little doubt of the expertise of those in the central accounts areas in the requirements of the banking statistics returns, but most of the classifications are carried out in operational areas and do not reach them. On that basis there is an argument for a national level check on the quality of the coding being done at branch level.

However a comprehensive check is unlikely to be effective. Within any realistic budget, it would be possible to check only a minute proportion of the accounts. With errors being fairly rare the sampling error of such an exercise would be unacceptably large.

ACTION: Accepted. However the need for selective sample surveys addressed to particular classification problems may still arise in the future.

(g) Maintain regular contact with the banks

The Bank of England already maintains close contact with major banks on a regular basis, so that they are well aware of statistical problems and are ready to take up problems with the Bank. However, several of the banks visited seemed to welcome the opportunity the visit provided to discuss statistical questions more generally. The Bank of England could therefore institute a series of seminars with some of the smaller British and overseas banks which could be used to discuss reporting developments and for the Bank to explain and emphasise the importance of correct reporting generally and classification in particular. This might be particularly valuable to banks outside London.

ACTION: Accepted. The Bank of England intends to hold a series of seminars for reporting banks to coincide with the introduction of new forms following the current banking statistics review. CSO will be invited to participate in these seminars.

(h) Increase CSO Resources

The experience of the project team is that there are benefits to be gained from greater involvement of the CSO in advising on the banking statistical returns and classification, and in the checking process. Currently there is no sector statistician within the CSO representing the banking sector or the financial institutions sector as a whole, nor is there a statistician in a position to examine banking instruments.

The system of firm agreements (quasi contracts between CSO and the Bank of England) and agreed work programmes implies a greater degree of leadership from the CSO, which in turn requires

rather more expertise and effort than has been necessary in the past. An additional statistician post should therefore be created within the CSO to take internal responsibility for the banking and financial institution statistics provided by the Bank of England.

ACTION: Accepted. An extra statistician post on financial institutions was created in April 1991. Since then further posts and a new Financial Institutions Branch have been created to accommodate the transfer of responsibilities for non-bank financial institutions from the Bank of England to CSO following on from the Eason report (6)

(i) Map out "best practice" of classification methods

In the visits to banks the team came across a wide variety of reporting systems. While a good and user-friendly system does not guarantee good reporting, it can make an important contribution. The Bank of England cannot lay down that certain methods should be followed, but it might be possible for some "standards" of good practice to be set out which the banks could aspire to if they were thinking of making enhancements to their existing systems.

ACTION: Many of the obvious "best practices" will be incorporated into the new version of the banking statistics definitions (the "red folder"). The Bank of England will review whether any further guidance is necessary once this is issued.

REFERENCES

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- (5) United Kingdom National Accounts (the Blue Book), HMSO, annual
- (6) Balance of Payments Statistics: A Review of Data Collection and Compilation, Richard Eason, CSO, 1991