Office for National Statistics

Article

Economic statistics classification article: statistical treatment of the Bank of England’s Term Funding Scheme in the UK national accounts and public sector finances

ONS has classified the Bank of England’s Term Funding Scheme (TFS) in accordance with international rules set out in the European System of Accounts 2010 (ESA 2010) and accompanying statistical manuals. ONS has concluded that its economic statistics will reflect the TFS in the public sector balance sheet through both a loan asset for the TFS lending to banks and building societies, and a deposit liability relating to the creation of central bank reserves. However, as the classification decision also dictates that the loan assets are to be recorded as illiquid assets, the impact of the TFS on the Public Sector Net Debt will be to increase it by the value of the central bank reserves created to fund the TFS lending (all else being equal). The Bank of England has indicated that the value of lending in the TFS could reach £100 billion. This paper describes how the TFS, which became operational in September 2016, works and based on this how ONS has decided that the scheme transactions and stock are to be classified in the National Accounts and related economic statistics. The classification review also took into account previous decisions on similar schemes, such as the Funding for Lending Scheme (FLS) and the Special Liquidity Scheme (SLS), and contrasts the classification decisions for these different schemes.

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Table of contents

1. Executive summary

2. Introduction

3. Term Funding Scheme (TFS): how it works

4. Term Funding Scheme (TFS): the classification

5. Conclusion

6. Annex: Similarities between the TFS, FLS and SLS

1 . Executive summary

We have classified the Bank of England’s Term Funding Scheme (TFS) in accordance with international rules set out in the European System of Accounts 2010 (ESA 2010) and accompanying statistical manuals.

We have concluded that its economic statistics will reflect the TFS in the public sector balance sheet through both a loan asset for the TFS lending to banks and building societies, and a deposit liability relating to the creation of central bank reserves. However, as the classification decision also dictates that the loan assets are to be recorded as illiquid assets, the impact of the TFS on the Public Sector Net Debt will be to increase it by the value of the central bank reserves created to fund the TFS lending (all else being equal). The Bank of England has indicated that the value of lending in the TFS could reach around £100 billion.

This article describes how the TFS, which became operational in September 2016, works and based on this how we have decided that the scheme transactions and stock are to be classified in the national accounts and related economic statistics. The classification review also took into account previous decisions on similar schemes, such as the Funding for Lending Scheme (FLS) and the Special Liquidity Scheme (SLS), and contrasts the classification decisions for these different schemes.

2 . Introduction

On 4 August 2016, the Bank of England's Monetary Policy Committee (MPC) announced a package of new measures to support the economy. This package included a new initiative called the Term Funding Scheme (TFS).

The TFS is part of the Asset Purchase Facility (APF) and the aim of the TFS is to reinforce the transmission of Bank Rate cuts to those interest rates faced by households and businesses. The TFS looks to achieve this by providing term funding to eligible banks and building societies at a rate at or close to Bank Rate, with the actual rate paid by banks being based on their net lending to households and businesses.

The TFS lending is supported by collateral provided by the banks and building societies, in the form of securities and/or loan portfolios. The TFS loan is provided for a 4-year period although at any stage the bank or building society may pay back the loan with no penalty for early redemption applied. When the TFS loan has been repaid the collateral can be returned to the participating bank or building society.

This classifications article explains how we will treat the classification of TFS in the fiscal statistics of the Public Sector Finances and the wider UK National Accounts. The paper first describes the Term Funding Scheme, and then explains how we have decided that this will be treated in economic statistics. Our decision is based on international statistical guidance in the European System of Accounts 2010 (ESA 2010) and UK guidance on the application of ESA 2010 when calculating the UK fiscal metrics of public sector net borrowing and net debt. The decision has been made by the Director of National Accounts and Economic Statistics following recommendations by the Economic Statistics Classification Committee (ESCC) and the Public Sector Finances Technical Advisory Group (PSFTAG). More information on the way that we make classification decisions is available on our website.

3 . Term Funding Scheme (TFS): how it works

The Term Funding Scheme (TFS) involves the Bank of England (via the Asset Purchase Facility) lending central bank reserves (cash) to eligible banks and building societies for which they will have to provide collateral, and pay interest that will be dependent on the volume of their net lending to households and businesses. The Bank of England has indicated that the value of lending in the TFS will be determined by usage of the scheme, and could reach around £100 billion.

We have reviewed the published terms and conditions and operating procedures for the TFS and concluded the following about the scheme; the Bank of England is providing to Monetary Financial Institutions (MFIs) cash loans (or at least cash equivalent electronic reserves) at a rate of interest close to Bank Rate, with the price and quantity of funding available depending on the MFI's net lending to the UK economy.

In return for the loan the MFI provides collateral to the Bank of England in the form of the securities and/or loan portfolio assets held by the MFI. The MFI providing the collateral assets will continue to receive the income flows relating to those assets.

The loan maturity is set at 4 years from the date of the advance but during that period the participating MFI may pay back the loan at any time with no penalty and request the return of collateral. Should the MFI be unable to pay back the loan then the Bank of England may recover its costs through realising the value of the collateral. The Bank of England manages the risk of losses through its valuation of the collateral prior to the loan being granted. In valuing the collateral the Bank of England applies a discount that is known as a “haircut”.

The MFIs participating in the TFS will pay interest on drawdowns at a rate determined as Bank Rate plus a participant-specific TFS fee that can vary between 0 and 25 basis points. The TFS fee and hence the actual rate of interest paid by each participant will be based on the volume and their net lending to households and businesses.

In order to fund the lending under the TFS the Bank of England creates central bank reserves. This is the same mechanism by which the Bank of England funds its purchase of gilts and corporate bonds within the Asset Purchase Facility. The Bank of England pays interest at the Bank Rate on the liability arising through the generation of the central bank reserves.

4 . Term Funding Scheme (TFS): the classification

In accordance with the European System of Accounts (ESA) 2010, and related international statistical manuals, we have concluded the following about the correct statistical recording of the transactions and stocks relating to the TFS.

- The creation of central bank reserves is to be shown as a cash (AF.22) asset and an other deposits (AF.29) liability. A corresponding other deposits (AF.29) asset is recorded for the UK financial corporation sector. This is the same treatment as is currently applied to the Asset Purchase Facility.
- The payments by the Bank of England on the liability relating to the creation of central bank reserves is to be recorded as interest (D.41). This is the same treatment as currently in the Asset Purchase Facility.
- The loan from the TFS to the participating bank and/or building society is to be recorded as a cash (F.22) flow from the Bank of England to the TFS participant, a long-term loan (AF.42) asset for the TFS, and a corresponding long-term loan (AF.42) liability for the TFS participant. (Note: The cash flow reduces the AF.22 level of the public sector by the same value as that of the AF.22 asset formed by the creation of central bank reserves.)
- Collateral assets provided against the loan are to be recorded on the balance sheet of the TFS participant.
- The income flows relating to collateral assets are to be shown as received by TFS participant.
- All loan fees or payments from the TFS participants to the Bank of England to be recorded as interest (D.41) and appropriately accrued.

These decisions mean, as a result of the TFS, that the public sector balance sheet contains a liability as a result of the creation of the central bank reserves and an asset as a result of the loans to TFS participants.

The cash asset formed by the creation of central bank reserves is transferred to the MFI sector as the loan (this transfer is represented by the cash (F.22) flow described above), and therefore there is no net change in the level of deposit (AF.22) assets on the public sector balance sheet and no impact on Public Sector Net Debt (PSND) from this cash asset.

To decide the impact on Public Sector Net Debt (PSND) it is necessary to decide whether the TFS loan asset is a liquid asset (which is included in PSND), or an illiquid asset (which is excluded from PSND). After reviewing the guidance on what constitutes a liquid asset we have concluded that:

- the loan assets are to be treated as illiquid assets as they are not tradeable and their value is not realisable by the Bank of England at short notice.

The impact of this classification decision on the main UK fiscal metrics is that (all else being equal) Public Sector Net Debt will be increased by the liability relating to the creation of the central bank reserves and Public Sector Net Borrowing will be decreased by the net interest flows relating to the TFS loans and central bank reserves.

5 . Conclusion

The classification decisions, set out in section 4, will impact on the UK National Accounts and related economic statistics including the Public Sector Finances.

The impact in the Public Sector Finances on Public Sector Net Debt (both PSND and PSND ex) will be to increase it by the liability relating to the creation of the central bank reserves (all else being equal). This could reach around £100 billion, dependent on how much banks and building societies choose to draw from the scheme.

The impact in the Public Sector Finances on Public Sector Net Borrowing (both PSNB and PSNB ex) will be to decrease it through the net interest flows liability relating to the Term Funding Scheme (TFS) loans and central bank reserves, in effect, to the extent of any non-zero TFS fees that are applied to TFS drawdowns (all else being equal).

These decisions will be implemented in the Public Sector Finances in the 22 November 2016 statistical bulletin. Implementation in national accounts and other economic statistics will take place after this at the earliest opportunity.

6 . Annex: Similarities between the TFS, FLS and SLS

While the Term Funding Scheme (TFS) is new it has a lot of similarities to the existing Funding for Lending Scheme (FLS) launched in 2012 and the now closed Special Liquidity Scheme (SLS) launched in 2008.

Funding for Lending Scheme (FLS)

The aim of the FLS is to boost the incentive for banks and building societies to lend to UK households and non-financial companies. The FLS (like the TFS) is designed to reduce funding costs for banks and building societies so that they can make loans cheaper and more easily available.

Where the FLS differs from the TFS is in how it operates. Unlike the TFS, the FLS is not operated through the Asset Purchase Facility. The FLS operates as follows: the Debt Management Office (DMO) lends UK Treasury bills to the Bank of England for a fee. The Bank of England (BoE) in turn swaps these Treasury bills with FLS participants in exchange for collateral and a “fee”. The Treasury bills lent are 9-month bills. Participants return maturing Treasury bills to the BoEDMO in a window between 10 and 20 days prior to maturity and receive in return new Treasury bills.

For the purposes of official statistics the FLS has been deemed to be stock-lending, meaning that from an economic ownership perspective the assets exchanged (Treasury bills and collateral) are considered to not change ownership. The Treasury bills are generated specially for the FLS and the classification means that they are treated as both central government assets and liabilities meaning that there is no impact on either the government balance sheet or public sector gross debt. Similarly, the collateral continues to be recorded on the balance sheets of the FLS participants.

The fees paid by BoE to DMO for the Treasury bills are recorded as a payment of interest, and similarly, the interest and fee payments from FLS participants to the BoE are treated as interest. The payments from FLS participant impact on public sector net borrowing as the interest received is recorded as revenue which has the effect of reducing public sector net borrowing, all else being equal. The cash received also has a small downward impact on public sector net debt.

Special Liquidity Scheme (SLS)

The aim of the SLS was described slightly differently to the FLS and TFS with the BoE describing the aim as: “to improve the liquidity position of the banking system and raise confidence in financial markets while ensuring that the risk of losses on the loans they have made remains with the banks".

Although the SLS had a different purpose to the FLS, the operation of the SLS was in most important features identical to that of the FLS. The Debt Management Office lent UK Treasury bills to the Bank of England for a fee. The Bank of England in turn swapped these Treasury bills with SLS participants in exchange for collateral and a “fee”. Participants returned maturing Treasury bills they held to the BoE/DMO prior to maturity receiving in return new Treasury bills.

The statistical recording of the SLS was the same as that for the FLS, that isstock lending with the fee transactions being recorded as interest. As with the FLS the Treasury bills remained under economic ownership of government and so there was no impact on the public sector net debt other than through the cash received in the form of interest and fees from the participants.

When the SLS was finally wound up there was a large surplus in the fund as a result of the differential between the fees paid by participants and those paid by BoE to the DMO. This surplus was transferred to the Exchequer and recorded as a dividend paid by BoE to HM Treasury.

Table 1: Summarising differences between TFS, FLS and SLS

	TFS	FLS	SLS
Purpose of scheme	To reinforce the transmission of Bank Rate cuts to those interest rates actually faced by households and companies	To reduce funding costs and improve the availability of credit to households and businesses	To improve the liquidity position of the banking system and raise confidence in financial markets
What is the Bank of England lending?	Central bank reserves	Treasury bills	Treasury bills
What is the duration of the loans?	4 years	4 years	3 years
What collateral is the Bank of England receiving?	Eligible securities and loan portfolios	Eligible securities and loan portfolios	Eligible securities
What “fees” are the Bank of England paying?	Bank Rate on central bank reserves	Fee to DMO to borrow Treasury bills	Fee to DMO to borrow Treasury bills
What “fees” are the Bank of England receiving?	TFS Interest = Bank rate + Fee. Fee is based on net lending activity of participant and can range from zero to 25 basis points.	Fee based on net lending activity of participant (25 basis points or more)	Fee based on difference between LIBOR and gilt repo rate
Statistical treatment	The original creation of the central bank reserves is recorded as a public sector liability to the UK financial corporation sector. Although the TFS loans to the financial corporation sector are assets they are recorded as illiquid assets and so public sector net debt is increased by the value of the liability relating to the creation of the central bank reserves. The “fees” are recorded as interest. The net interest (all else being equal) will reduce public sector net borrowing and the net cash received will reduce public sector net debt.	Treasury bills remain under the economic ownership of government and do not therefore impact public sector net debt. The “fees” are recorded as interest. The net interest (all else being equal) will reduce public sector net borrowing and the net cash received will reduce public sector net debt.	The Treasury bills remained under the economic ownership of government and do not therefore impact public sector net debt. The “fees” are recorded as interest. The net interest (all else being equal) will reduce public sector net borrowing and the net cash received will reduce public sector net debt.

Source: Office for National Statistics