UK Statistics Authority

Statement

12 June 2013

Statistics relating to transfers from the Asset Purchase Facility Fund

The UK Statistics Authority has today published a report into the statistical treatment of changes to cash management arrangements between the Bank of England Asset Purchase Facility Fund (BEAPFF) and HM Treasury. The Statistics Authority endorses the report and has asked ONS to implement its findings.[1]

In February 2013, the Office for National Statistics (ONS) announced its decision that the cash flows from the Bank of England to HM Treasury, in respect of the BEAPFF holdings of excess cash, should be treated as permanent effects of a financial intervention. These cash flows would, therefore, reduce the headline measure of Public Sector Net Borrowing ('PSNB ex') which excludes the temporary effects of financial interventions. The announcement from ONS prompted concerns from some media commentators that the decision might not have been consistent with previously published principles and criteria for the production and publication of public sector finance official statistics.

The report is attached overleaf and is also available at the following link:
http://www.statisticsauthority.gov.uk/reports---correspondence/reports/index.html.

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For media enquiries about this Statement please contact +44 (0)7786 892263

[1] The *Statistics and Registration Service Act 2007* established the UK Statistics Authority as an independent body at arm's length from government with direct reporting to Parliament and the devolved legislatures, rather than through Ministers, and with the statutory objective of promoting and safeguarding the production and publication of official statistics that "serve the public good". The Authority's functions relate to its statutory areas of responsibility which include oversight of the UK official statistics system and governance of the Office for National Statistics.

UK STATISTICS AUTHORITY

STATISTICS RELATING TO TRANSFERS FROM THE ASSET PURCHASE FACILITY FUND

Review of the treatment in Public Sector Finance Statistics of changes to cash management arrangements between the Bank of England Asset Purchase Facility Fund and HM Treasury

1. The review was prompted by concerns expressed to the UK Statistics Authority about the way a change in cash management arrangements between the Bank of England and HM Treasury has been reflected in the fiscal measure 'PSNB ex' – Public Sector Net Borrowing excluding the temporary effects of financial interventions. The change relates to cash held in the Bank of England Asset Purchase Facility Fund (BEAPFF).

2. The review team comprised Partha Dasgupta, Board member of the UK Statistics Authority; Professor Sir Tony Atkinson, Nuffield College, University of Oxford; and Richard Alldritt, Head of Assessment at the UK Statistics Authority.

3. This report will be submitted to the Board of the UK Statistics Authority and it will be for the Board to decide what specific action to take or recommend in the light of the review team's conclusions.

Summary and conclusions

4. On 21 February 2013, the Office for National Statistics announced[1] a decision that the cash flows from the Bank of England to the Treasury, in respect of the BEAPFF holdings of excess cash[2], should be treated as permanent effects of a financial intervention. These cash flows would therefore reduce the headline measure of Public Sector Net Borrowing (PSNB ex) which excludes temporary effects of financial interventions. The decision was based on a recommendation of the Public Sector Finances Technical Advisory Group (PSFTAG) to senior ONS managers and the National Statistician. The announcement prompted concerns from some commentators that the decision might not have been consistent with previously published principles and criteria – and that it might have been influenced by presentational considerations rather than purely statistical considerations.

[1] The 'Classification Statement' is referenced at Annex 1.
[2] The scheme is outlined at paragraph 25 below.

5. The review team considered a number of related questions:

   i) **Guidance** - Whether the criteria, definitions and principles in the guidance on the ‘ex measures’ issued by ONS (the ‘2010 Guidance’ as referenced below) are sufficiently precise, clear and relevant.

   ii) **Communication** - Whether the decision itself and the processes by which it was taken were adequately explained and communicated externally so as to maintain confidence in the processes for such decisions.

   iii) **Governance** - Whether there are any aspects of the processes by which the recommendation was made and approved that need to be clarified, changed or considered further.

   iv) **Decision** - In relation to the treatment (in the Public Sector Finance Statistics) of the changes in the cash management arrangements, whether the decision taken was the most reasonable interpretation that could be made of the published criteria, definitions and principles (taking account of arguments relating to precedent and consistency, both over time and in respect of international practice and the statistical treatment of other financial interventions).

Conclusions

Guidance

6. We were told by ONS that, in deciding the recommendation to be put forward by the PSFTAG committee, some sentences in the 2010 Guidance were no longer seen as relevant and applicable. In that sense, the interpretation adopted by ONS of the guidance was, in some aspects, selective. The review team finds this unsatisfactory. The Guidance was in the public domain and whilst there were grounds for updating it and clarifying how it should be interpreted, that should have been done and explained openly – which would have enabled discussion and challenge. This applies in particular to the interpretation of Principle 2 of the Guidance and related statements later in the text of the 2010 Guidance. External commentators could reasonably have expected those statements to be seen as applying to the scheme both before and after the change to the cash management arrangements particularly in the absence of any clear public statement to the contrary. The correspondence from the Economics Editor of the Financial Times (paragraph 31(ii) below) draws attention to this point.

7. We note in passing that the 2010 Guidance is not clearly labelled with a date or version, potentially leaving doubt about whether it is current. We think all such sets of criteria and definitions should be clearly marked, at least with the date of the latest revision.

Communication

8. The review team has concerns about whether various matters (the statistical arguments underlying the decision itself; the fact that alternative arguments were considered and the reasons for rejecting them; and the changes to governance and guidance) were adequately communicated externally. We recognise that ONS had little advance warning of the 9 November 2012 announcement and had to move quickly, and that this inhibited steps that may seem desirable in hindsight. This was exacerbated by the novel and complex nature of the decisions that needed to be

taken. However, the risk of undermining confidence associated with taking important decisions without explaining fully to users the processes, principles and decisions should be seen as an important consideration.

9. We have a more specific concern that the Classification Statement[3] of 21 February 2013 might be read as invoking European guidance (in relation to the Maastricht deficit and debt definitions) in support of the decision about the treatment of the changes in cash management arrangements in PSNB ex. As noted at paragraph 18(iii) below, the Maastricht definitions do not constrain the decision on statistical grounds. In addition we note that the National Accounts Classification Committee, though relevant for decisions about National Accounts, was not relevant to deciding where the ex boundary lay.

10. We note that since March 2013 ONS publishes the PSNB ex figures on both the current definition and on the alternative basis of treating the flows from the BEAPFF as temporary. Table 2 in the Public Sector Finances Statistical Bulletin provides figures for PSNB ex excluding the Royal Mail Pension Plan and the Asset Purchase facility and these figures are National Statistics. Thus, it is not a question of whether statistics on the alternative basis should be published – they already are – but rather one of whether as time goes on it remains appropriate to continue to treat the ex measures as the headline measure.

Governance

11. The review team has strong reservations about the committee arrangements and the approval process in respect of recommendations from the PSFTAG committee. An article published by ONS in June 2012[4], in response to a formal Assessment Report[5] by the UK Statistics Authority, sets out the current arrangements although these have subsequently been modified in some respects.

12. The Assessment Report stated that 'ultimately a single organisation must be responsible for statistical decisions' and the ONS article published in response sought to explain where responsibility falls between ONS and the Treasury for particular decisions. In respect of the PSFTAG it says that: 'If there are classification issues in the transition from the National Accounts to the fiscal framework, then decisions on these are made at a sub-group of the PSFDG[6] known as the Public Sector Finances Technical Advisory Group (PSFTAG). This is made up of two voting representatives from HM Treasury, two from ONS and one from DCLG. The Bank of England can also attend the group but does not have a vote. … The decision of the PSFTAG is then presented to the PSFDG for ratification.' In the current case, the decision of PSFTAG was in fact referred to senior ONS managers and the National Statistician for agreement. We support that change which makes the arrangements more consistent with the expectations of the Assessment Report than the process involving the PSFDG committee outlined in the article.

13. However, this change to the arrangements for consideration of PSFTAG recommendations was a substantive one and should have been publicly announced and explained following a decision to change it in November 2012.

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[3] Referenced at Annex 1

[4] http://www.ons.gov.uk/ons/rel/psa/public-sector-finances/production-of-the-public-sector-finances-statistical-bulletin--responsibilites-and-accountabilities/art-psf-sb--responsibilities-and-accountabilities-.html

[5] http://www.statisticsauthority.gov.uk/assessment/assessment/assessment-reports/assessment-report-144---statistics-on-public-sector-finances.pdf

[6] The Public Sector Finances Data Group which is the main forum, meeting quarterly, at which changes to the PSF bulletin are discussed and agreed.

14. In the light of the recent practical experience, we see no strong case to support the current composition and voting arrangements of PSFTAG. The use of the phrase 'voting representatives' is unfortunate. This could leave the impression that the recommendations of the committee are a matter of voting between representatives of departmental interests, although we were told, and accept, that this is not in fact how the committee operates. We think that ONS ought to take undivided responsibility for such decisions, seeking advice from experts through whatever ad-hoc or permanent committees are seen by ONS to be appropriate to the decision.

15. More generally, the ONS may wish to return to the issue raised in the Assessment Report about whether it would be more appropriate for one organisation to take full responsibility for the *Public Sector Finances Statistical Bulletin,* which is currently published jointly by ONS and HM Treasury.

16. We understand that senior managers gave close consideration to the recommendation of the PSFTAG group before approving it but we find it unsatisfactory that this was not fully documented at the time and that, in particular, it is not clear to the review team what consideration was given to the minority view recorded in the minutes of the PSFTAG meeting.

Decision

17. The review team concludes that the decision to treat the flows of money from the BEAPFF to the Treasury as permanent was made after diligent and professional consideration by the PSFTAG committee and senior managers. We recognise that they paid close attention to the published guidance and principles, to precedents established in relation to other financial interventions[7], and to questions of alignment with international practice. However, treating the transfers as temporary is a reasonable conclusion from the published guidance and one which many users are likely to have drawn.

18. The review team concluded this for the following reasons:

    i. Principle 2 of the 2010 Guidance states that 'Permanent effects from financial interventions are those that will ultimately have an effect on central government's net debt or net borrowing.' The interpretation that the PSFTAG committee adopted of the phrase 'ultimately have an effect' was that the effect on net debt and borrowing would be substantive - in the sense that it would change substantively the borrowing requirement and debt levels of Government. This interpretation was preferred to interpreting the phrase as relating to the eventual net effect of the intervention on debt and borrowing that would be recognised following its completion or closure. This latter interpretation seems to us, in the case of the BEAPFF scheme, to be the more reasonable one. It therefore seems to us more reasonable and intuitive to regard the transfers as not being 'permanent' according to this definition. We note that the Chancellor's letter[8] of 9 November 2012 to the Governor of the Bank of England referred explicitly to the likelihood of the transfers being reversed. So 'ultimately', some or all of the benefit in terms of reduced borrowing and debt might be expected to be undone.

[7] See paragraph 39.

[8] http://www.hm-treasury.gov.uk/d/chx_letter_091112.pdf

ii. Subsidiary to the point above, we conclude that the interpretation adopted of the phrase ‘that will ultimately have an effect on central government’s net debt and net borrowing...’ should have been informed by a paragraph later in the guidance which states ‘The assets acquired by the BEAPFF will, in time, be sold back to the market.......It is at this point that the effect of the scheme will be regarded as permanent.’ [9] The review team considers that most readers would assume that the intended meaning of ‘ultimately’ is that indicated in the quoted sentence.

iii. The argument that, in deciding the treatment of the transfers, substantial weight should be given to maintaining close alignment between
   a) the deficit and debt figures reported in the regular *Government Deficit and Debt Under the Maastricht Treaty* Bulletin and
   b) the figures for ‘PSNB ex’ in the public sector finance statistics,

   seems essentially a presentational argument rather than a statistical one. We note ONS’s argument (paragraph 37) that maintaining consistency with the Maastricht measures is important to the credibility of the fiscal measures but we take the view that some difference between the figures is a reasonable consequence of the different definitions employed.

19. These considerations lead us to the conclusions indicated at paragraph 17 above. We note that the PSFTAG committee recognised that the matter was not a clear-cut one, that the committee considered and recorded counter-arguments in its minutes, and that the recommendation it made was not unanimous.

20. There is a further consideration which reinforces the review team’s conclusions. The changes to the cash management arrangements did not change the Asset Purchase Facility Fund scheme in any fundamental way. The scheme as it stands following the change will have essentially (though not exactly) the same long term effect on public borrowing and debt as if the change had not taken place. In a press notice[10] on 9 November 2012, the Office for Budget Responsibility said that the change ‘should not in itself have a significant impact on the eventual net profit or loss to the Exchequer…’ Given the concept behind the ‘PSNB ex’ measure, it is reasonable for commentators to expect, and want, the ‘ex’ measures to be consistent before and after a change that only affects the cash management arrangements.

21. Given the arguments and counter-arguments that apply in this case, it is evident that there are very real difficulties in establishing a robust and clear definition of the ‘ex’ measures. In the light of this, we further conclude that any change to the PSF statistics should be preceded by a wider review of the statistical definition of PSNB ex and PSND ex to ensure that the treatment of the various financial interventions is as coherent and reasonable as possible in the short term, and that the longer term viability and relevance of the ‘ex’ measures is taken in to account. There is a case to be argued that the ‘ex’ measures should only be regarded as headline measures of debt and deficit for a relatively short time after their introduction and that after that they should be presented simply as one of range of analyses of the available statistics. We welcome the fact that ONS is already planning a review of the 'ex' measures.

[9] These quotes are from the document referenced in Annex 1 as the ‘2010 Guidance’
[10] http://budgetresponsibility.independent.gov.uk/pubs/APFpn.pdf

The report

22. The rest of this report is structured as follows.
    - An introduction of the PSNB ex measure
    - A description of the Asset Purchase Facility Fund
    - A summary of the flows of money in the scheme
    - The concerns expressed
    - The ONS arguments
    - The review team's observations
    - Annex 1: Key documents
    - Annex 2: Extracts from key documents
    - Annex 3: Terms of Reference

The PSNB ex measure

23. A measure of public sector net debt excluding the temporary effects of financial interventions, known as **PSND ex**, was introduced in the 2008 Budget. A parallel measure of public sector net borrowing, known as **PSNB ex**, was introduced in the 2009 Pre-Budget Report[11]. That report stated:

    "This Pre-Budget Report ... sets out a new definition of net borrowing, PSNB excluding the temporary effects of financial interventions, which excludes the distortionary and temporary effects of the publicly-owned banks and the Bank of England Asset Purchase Facility Fund. This measure will be published in outturn by the ONS alongside the measure for PSND, which is already published."

24. In effect, these measures are intended to show the underlying state of the public sector finances without temporary distortions caused by financial interventions, but including any permanent effects from these interventions. ONS stated in the 2010 Guidance that:

    "PSNB ex and PSND ex are based on, and consistent with, National Accounts definitions and methodology, both in terms of the transactions that feed into their calculation and the institutions between which these transactions take place."

The Asset Purchase Facility Fund

25. In 2009, the Bank of England established a separate company, Bank of England Asset Purchase Facility Fund[12] Ltd (BEAPFF), as the vehicle to undertake Quantitative Easing (QE). There were two phases to the activities of the BEAPFF. The first phase involved the purchase of corporate bonds issued by private sector corporations. These asset purchases were financed by the issuance of Treasury bills and the UK Debt Management Office's cash management operations. The commercial paper purchases had no effect on PSND because they were treated as liquid assets and cancel out the borrowing used to finance the purchases.

[11] http://www.hm-treasury.gov.uk/d/pbr09_completereport.pdf paragraph 1.16

[12] This description of the Bank of England Asset Purchase Facility Fund is based on the ONS Classification Article, as referenced in Annex 1.

26. In the second phase, the fund purchased assets (mainly gilts), financed by issuance of central bank reserves. In the calculation of PSND, the creation of central bank reserves is a liability of the public sector and is equal to the amount paid to acquire the assets (i.e. their market value at the time of purchase); by contrast, the assets are by convention recorded at nominal value. The difference between the valuation of the liability on the BEAPFF and the corresponding asset adds to PSND. A further addition to net debt arises from the purchases of corporate bonds.

27. The BEAPFF has since bought assets worth almost £375 billion. The vast majority of these assets are UK Government gilts, bought on secondary markets, with a range of maturities. As a result of these purchases, the BEAPFF receives large coupon (interest) payments from the Treasury. Although it also pays interest on the loan from the Bank of England these interest payments have been much lower than the interest received and so the cash has been building up into a cash reserve.

28. Over time, the expectation has always been that Quantitative Easing will end, and that the gilts will be sold back to the market. The accumulated cash reserve was being retained to cover any losses made by the BEAPFF as Quantitative Easing was unwound. However, the activities of the BEAPFF are subject to an indemnity (guarantee) from HMT, such that HMT is entitled to any profit the BEAPFF eventually makes and is responsible for any losses it incurs. In the longer term, as Quantitative Easing is unwound, should the BEAPFF make losses, then HMT will transfer over money to cover any loss made.

29. The BEAPFF is classified by the ONS as if it were simply part of the Bank of England. The Bank of England is classified as a Public Sector Financial Corporation, and therefore not part of the Government sector.

The flows of money

30. Under the scheme as it now operates, there are several flows of money, either actual or prospective, back and forth between the Asset Purchase Fund, the Bank of England and the Treasury. The ones most relevant to the issues in this review are as follows.

    i. The purchase of gilts by the BEAPFF – this may have some indirect beneficial effect on Treasury revenues in the shorter term, balanced by a liability to compensate the Bank for any losses in the longer term.

    ii. The payment of interest by the Treasury on the gilts held by the BEAPFF – has the effect of contributing to the need for public sector borrowing in the shorter term but reducing the need for Treasury to compensate the Bank in the longer term. It can be argued that the Treasury would have had to pay interest on these gilts whoever owned them and thus the interest payments, of themselves, are outside the financial intervention. Or, it can be argued that the scheme is outside the public sector and so these payments must be treated as for other interest payments to private sector holders of gilts, and so they are ‘permanent effects’ of the scheme. Either way, they have the same effect on PSNB ex.

    iii. The interest payments made by the BEAPFF to the Bank of England on the original loans from central bank reserves. Has the effect of reducing the surplus cash held by BEAPFF.

iv. The repayment of surplus cash from the BEAPFF to the Treasury – reduces the need for public borrowing in the short term but increases the Treasury's long term liability in terms of the likely need to compensate the Bank. It is the status of this flow of money which is at issue in this report. In practice, this flow has an impact on both net borrowing and net debt. As the payments relate to accumulated cash over a number of years, only an element (the entrepreneurial income, taken to be the consolidated profits of the previous year) may contribute to lowering net borrowing, with the remainder (the super dividend), treated as a financial transaction, lowering net debt on the balance sheet. In the calculation of the super dividend test for 2012/13, the profits of the Bank of England were assumed to be the consolidated profits of the Issues Department, the Special Liquidity Scheme and the Asset Purchase Facility Fund. Considerations of where each distinct part of the BoE lies with respect to the 'ex boundary' was not taken in to account in this calculation.

v. The possible future flows of cash from HM Treasury to the Bank of England to cover losses made by the BEAPFF - no effect in the short term but will increase borrowing at some future time; or reduce it if the scheme makes a surplus. So these flows would be 'permanent effects'.

The concerns expressed

31. In a letter[13] dated 28 February 2013, Chris Giles, Economics Editor of the Financial Times argued as below. Where he quotes from documents, we have added the short names we are using in this report.

i. "The ONS technical note [the Classification Article] ignored the initial principle outlined at the start of the guidance note [the 2010 Guidance] that the purpose of the "ex measures" was to show the underlying state of the public finances without temporary distortions.

ii. "The ONS ignored a clear statement of the correct accounting treatment of the BEAPFF for the 'ex measures' in the guidance note [the 2010 Guidance]. In the section on financial interventions on page 7, the guidance note states clearly: 'The assets acquired by the BEAPFF will, in time, be sold back to the market. Any shortfall will be made up by central government while any profit on closure of the scheme will be retained in the public sector. It is at this point that the effect of the scheme will be regarded as permanent. The current effects are regarded as temporary and excluded from both PSND ex and PSNB ex'. The clear guidance is that the 'ex measures' should ignore potential losses or profits from the BEAPFF until closure of the scheme, yet the classification decision made no reference to this clear statement of principle. I was alarmed to find this paragraph was not deemed worthy even of discussion in the technical note [the Classification Article].

iii. "The ONS technical note [the Classification Article] selectively quoted from the guidance note [the 2010 Guidance]. The passage quoted related to the second principle in the calculation of the 'ex measures'. That principle states: 'Permanent effects from financial interventions are those that will ultimately have an effect on central government's net debt or net borrowing. This includes transactions involving central government and central government run schemes, such as the

[13] http://www.statisticsauthority.gov.uk/reports---correspondence/correspondence/email-from-chris-giles-to-andrew-dilnot---28022013.pdf

asset protection scheme and credit guarantee schemes'. The guidance note did not demonstrate the changes to cash management would ultimately have an effect on central government's net debt or net borrowing. Indeed, the Treasury and the Bank of England have been clear that this cash management exercise was not a demonstration of an expected eventual profit from quantitative easing. The Treasury press release of 9 November[14] is explicit in stating 'at some point in the future, as monetary conditions normalise, it is likely that the cash flows will need to be reversed'. The expectation in government therefore that it is more likely than not for this to be a temporary flow of cash.

iv. "The ONS misinterpreted the word 'only' in its guidance note [the 2010 Guidance]. The reasoning for declaring the transfer of cash to be permanent and therefore counting for the 'ex measures' appears to be a misinterpretation of the word 'only' as 'always'. In the sentence, all common sense interpretations of the word 'only' as 'only able to be regarded as having a permanent effect when there is an impact on the central government finances'. It is a necessary condition for the flows to be treated as permanent, not a sufficient condition."

The ONS arguments

32. The following paragraphs reflect the review team's understanding of the rationale that led to the recommendation of the PSFTAG committee that the transfers of money from the BEAPFF to the Treasury should be treated as 'permanent effects' of the financial interventions and therefore have the effect of reducing the headline deficit measure now (PSNB ex) and causing it to increase in future years when the flows are reversed.

33. ONS notes four main considerations.
    i. Application of the principles in the 2010 guidance.
    ii. Consistency with precedents and previous decisions.
    iii. Consistency with National Accounts and the associated international guidance.
    iv. The implications that would follow from treating the cash flows as temporary effects rather than as permanent ones.

34. As background, ONS produces two publications relating to public sector borrowing and debt: the monthly *Public Sector Finances Statistical Bulletin*; and the bi-annual *Government Deficit and Debt Under the Maastricht Treaty Statistical Bulletin*. It has been an essential principle of the UK's Public Sector Finances that the statistics have been based on National Accounts definitions and methodologies (which are based on international standards) since 1997. This means that classification decisions in relation to the National Accounts and the Maastricht measures feed through into Public Sector Finance statistics.

35. The Public Sector Finances (PSF) Bulletin covers the whole of the public sector and provides further details for subsectors, including general government. Net debt and net borrowing figures are provided on two bases: a) total public sector, and b) excluding the temporary effects of the financial interventions. The "ex" definition is a construct i.e. not precisely defined by National Accounts Classification concepts.

36. The 'Maastricht' bulletin relates to the General Government sector only and the deficit measure covers all financial flows into and out of the General Government

[14] The Treasury Statement referenced at Annex 1

sector. The debt measure includes all General Government debt. In practice, there are three differences between the PSF general government figures and the corresponding Maastricht ones:

- The Maastricht measure focuses on Gross Debt whereas the headline measure for the Public Sector Finances is Net Debt (i.e. it nets off liquid assets). However, both bulletins publish the figures for gross debt.
- The Public Sector Finances Bulletin uses the National Accounts definition for net borrowing whereas the Maastricht measure includes certain interest flows which are not included within National Accounts. This is due to the European regulation relating to the Maastricht measures not being fully aligned with the ESA 1995 National Accounts regulation.
- The timing of accruals for Single Use Military Equipment expenditure.

37. Both net and gross debt are well established concepts and understood by users. The other two differences tend to be small and can be measured and explained easily. ONS argues that consistency between Public Sector Finances and National Accounts measures (and hence the links with the Maastricht measures) is important in establishing the credibility of UK fiscal measures which, through the linkage to National Accounts, can be shown to be independent and free from any inappropriate political influence.

38. The original definitions of the "ex" measures were set out in '*Public sector finances excluding financial interventions'*. (the '2010 Guidance'). This defines whether public sector finance transactions and balance sheet positions are classified as permanent or temporary. The diagram in Annex D to the document shows that when the guidance was produced, the BEAPFF and its activities were regarded as temporary whereas the flow of gilt interest payments from the Government to the BEAPFF was regarded as permanent. The BEAPFF is treated as a temporary effect on the public sector finances to reflect that although the BEAPFF was purchasing gilts from the private sector, it would eventually sell them back to the private sector. Because of this, interest payments from Government to the BEAPFF are not treated as payments between public sector bodies when calculating PSNB ex, and so score as permanent flows which impact on PSNB ex. This is one of the reasons why PSNB ex has, for a period of years, been higher than the PSNB measure which includes the temporary effects of the financial interventions. As the BEAPFF was defined as operating outside general government, the PSF and Maastricht definitions were identical except for the minor differences explained above.

39. So one part of ONS's argument was that to maintain the alignment of the PSF definition with the Maastricht one, it would be necessary for the transfers of money from the BEAPFF to the Treasury to be treated as permanent transactions, reducing 'PSNB ex'. If the transactions had been considered as temporary then it would have been the first time that the UK had introduced significant inconsistencies between the Maastricht and PSF measures of General Government borrowing and debt.

40. ONS also argued that there is an underlying logic to the way that the "ex" measures have been implemented. Once a scheme is treated as temporary then the transactions of that scheme with the private sector (or other "temporary" bodies) are outside PSNB ex, while transactions of that body or scheme with government or the Bank of England are inside PSNB ex. This is ONS's interpretation of Principle 2 of the 2010 Guidance which states that payments which ultimately impact on Central Government debt and borrowing are considered permanent effects. In these cases the payments would be impacting on the requirements for gilts and hence impact on borrowing requirements. Irrespective of whether there are later flows in the other

direction, the change in demand for borrowing now will have an ongoing impact on Central Government borrowing and debt due to the changes in interest payments. This interpretation was preferred by ONS to interpreting the guidance as relating to the eventual net effect of the intervention on debt and borrowing that would be recognised following its completion or closure. One implication of the interpretation adopted would seem to be that all transfers from a financial intervention scheme to the Treasury which affect the amount of borrowing and debt will be regarded as permanent.

41. ONS considered that treating the cash transfers to and from the BEAPFF as permanent was consistent with the paragraph on Page 7 of the 2010 Guidance:

> "The assets acquired by the BEAPFF will, in time, be sold back to the market. Any shortfall will be made up by central government while any profit on closure of the scheme will be retained in the public sector. It is at this point that the effect of the scheme will be regarded as permanent. The current effects are regarded as temporary and excluded from both PSND ex and PSNB ex."

42. ONS took the view that there were many examples where payments across the ex-measure boundary made in one direction would be offset partially or in full with a payment in the opposite direction without being treated as temporary. And that it is unlikely that payments from HM Treasury back to the Asset Purchase Facility will exactly match the level of payments from the Asset Purchase Facility to HM Treasury. The Office for Budget Responsibility has estimated that the end position will be around a £45 billion surplus by 2022/23, even though there will be some payments from HM Treasury to the Bank of England.

43. ONS further argues that if the flows had been classified as temporary effects, there would have been a number of undesirable consequences:

i. Although PSNB ex and Central Government Net Borrowing would not be affected by the cash transfers, cash would in the real world have been transferred and this would be recorded within the central government net cash requirement.

ii. Large differences would emerge between CGNB in National Accounts (and Maastricht measures) and CGNB in Public Sector Finances. Inconsistencies of this size (between £6 billion and £13 billion a year) would be liable to cause considerable confusion for users and undermine confidence. This would also cause concerns at the European level, where consistency between domestic and international measures is valued.

iii. Inconsistency between the treatment of the cash flows from the BEAPFF to government and other payments to and from government (such as the BEAPFF interest payments and public sector bank fees) would lead to lack of clarity for users and remove the basis of consistency and precedents from classification decisions. This would open up the opportunity for those with vested interests to argue for the exclusion of other flows from fiscal measures.

iv. Lack of clarity for users about exactly when (and under what conditions) the net effect of the cash flows would crystallise and so be recorded in PSNB ex and PSND ex.

v. The willingness of ONS to move Public Sector Finances away from National Accounts treatments in this instance could lead to pressure to re-define the UK fiscal measures further in the interest of political expediency rather than in the interests of public scrutiny and transparency.

44. Thus, in the opinion of ONS, the decision taken was less open to criticism than the alternative option of recording the flows as temporary effects of financial interventions.

45. So, in summary, the essence of the ONS argument seemed to be:

i. that the principles in the 2010 Guidance required that because the transfers from the BEAPFF to the Treasury have a substantive effect on debt and borrowing they should be treated as 'permanent';
ii. that there was established precedent for regarding flows of money from a temporary financial intervention to the Treasury as permanent effects of that intervention;
iii. that the close correspondence between the figures used in Maastricht reporting and the PSF statistics needed to be retained as far as possible; and
iv. that there would be negative consequences from treating the flows from the BEAPFF to the Treasury as temporary.

The review team's observations

46. The review team recognises that all the points considered by the PSFTAG committee and senior managers in reaching a decision needed to be considered. The concept of the 'ex' measures is not as clear-cut as it might appear and the question of whether to maintain close alignment with the figures used in Maastricht reporting, whilst not a statistical constraint, is potentially a matter of consequence both for the UK's international reputation and for the coherence of public debate about debt and borrowing levels. Similarly, the question of the relevance of precedents arising from other financial interventions is clearly important for consistency.

47. However, we find the counter-arguments to be more persuasive for the reasons outlined in paragraphs 17 to 21 above. The key points are these:

i. Whilst the decision was made after diligent and professional consideration of the arguments, the interpretation adopted of Principle 2[15] of the 2010 Guidance, particularly the phrase 'ultimately have an effect' was that the effect on net debt and borrowing would be substantive. This interpretation was preferred to interpreting the phrase as relating to the eventual net effect of the intervention that would be recognised following its closure. This latter interpretation seems to us, in the case of the BEAPFF scheme, to be the more reasonable one. It therefore seems to us more reasonable to regard the transfers as not being 'permanent' according to this definition. As the Governor of the Bank of England put it in his letter[16] of 9 November 2012, the new cash management arrangements are "likely to lead to the need for reverse payments from the Government to the APF in the future…". That is a strong indication of their temporary nature.

[15] Principle 2 states that 'Permanent effects from financial interventions are those that will ultimately have an effect on central government's net debt or net borrowing.'
[16] http://www.bankofengland.co.uk/monetarypolicy/Documents/pdf/govletter121109.pdf

ii. More specifically, the interpretation adopted of the phrase in the 2010 Guidance ‘that will ultimately have an effect on central government’s net debt and net borrowing...’ should have been informed by the later paragraph which states ‘The assets acquired by the BEAPFF will, in time, be sold back to the market ...It is at this point that the effect of the scheme will be regarded as permanent.’ We note that the PSFTAG committee took the view that this part of the Guidance was no longer applicable but we consider that most readers would assume that the intended meaning of ‘ultimately’ is that indicated in the quoted sentence.

iii. The precedents quoted by ONS do raise the question of whether treating the payments from the BEAPFF to the Treasury as temporary would have introduced inconsistency in to the ‘ex’ measures. However, rather than simply following those precedents, which relate to schemes very different from the BEAPFF, the review team thinks it is now necessary to review the definitions and relevance of the ‘ex’ measures more fundamentally (see paragraph 21).

iv. The argument that, in deciding the treatment of the transfers, substantial weight should be given to maintaining close alignment between the deficit and debt figures reported for ‘PSNB ex’ and those used in Maastricht reporting is essentially a presentational rather than a statistical argument. The presentational awkwardness of having divergent figures may be seen as part of the price of working with more than one concept of public sector borrowing.

v. The changes to the cash management arrangements did not change the BEAPFF scheme in any fundamental way. The scheme as it stands following the change in cash management will have almost the same long term effect on public borrowing and debt as if the change had not taken place. Given the underlying concept of excluding distortionary and temporary effects, it is reasonable for commentators to expect, and want, the ‘ex’ measures to be consistent before and after the change in cash management.

vi. The review team notes the ONS concerns, at paragraph 43 above, that treating the flows as temporary could have negative consequences. However we consider these potential consequences to be inherent in the definition of the ‘ex’ measures and in treating them as the headline measures of borrowing and debt. This again supports the case for a more fundamental review.

The review team
May 2013

Annex 1: Key documents

48. For ease of reference we have given short names to some published documents that are referenced in this report. The most relevant extracts from these documents are summarised in **Annex 2.**

- **The 2010 Guidance –** a paper published in March 2010 by ONS which sets out criteria and definitions for the relevant measures. Its title is Public sector finances excluding financial interventions. http://www.ons.gov.uk/ons/rel/psa/public-sector-finances/including-finance-lease-liabilities-in-public-sector-net-debt--pfi-and-other/public-sector-finances-excluding-financial-interventions.pdf

- **The Treasury Statement –** *Changes to cash management operations*, 9 November 2012. This sets out the changes associated with the agreement between the Government and the Bank of England to transfer to the Exchequer the excess cash held in the BEAPFF. http://www.hm-treasury.gov.uk/press_109_12.htm

- **The Classification Statement –** issued by ONS on 21 February 2013. Its title is Treatment in Official Statistics of the Cash Transfers from the Bank of England Asset Purchase Facility to HM Treasury. http://www.ons.gov.uk/ons/media-centre/statements/treatment-in-official-statistics-of-the-cash-transfers/index.html?format=print

- **The Classification Article –** published on 21 February 2013 alongside the statement on the treatment of the transfers. Its title is Changes to Cash Management Arrangements between the Bank of England Asset Purchase Facility and HM Treasury. http://www.ons.gov.uk/ons/guide-method/classifications/na-classifications/classification-articles/changes-to-cash-management-arrangements/index.html

Annex 2: Extracts from the key documents

The 2010 Guidance

In March 2010, the Office for National Statistics published a paper with the title *Public sector finances excluding financial interventions*[17]. Passages of particular relevance include:

> Extract 1
>
> "When calculating the ex measures, the key is to identify whether transactions and balance sheet positions are temporary effects of the financial crisis that will be eventually reversed, or whether they are permanent. Temporary effects on PSNB or PSND need to be removed when moving to the ex measures; permanent effects that are not captured as a result of removing the temporary effects need to be specifically included.
>
> There are four key principles that underpin the calculation of the ex measures:
>
> 1. Public sector transactions and balance sheet positions that are not related to financial interventions contribute to the ex measures. This applies to central government, local government, non-financial public corporations and the Bank of England
>
> 2. Permanent effects from financial interventions are those that will ultimately have an effect on central government's net debt or net borrowing. This includes transactions involving central government and central government run schemes, such as the asset protection scheme and credit guarantee schemes
>
> 3. All other effects are regarded as temporary and do not affect the ex measures
>
> 4. Payments or receipts related to permanent effects are recorded in the month in which they occur for PSND ex. For PSNB ex, the timing of recording is in line with National Accounts accruals principles
>
> In relation to the second principle:
>
> - a permanent effect may also arise if local authorities fail to recover their deposits with Icelandic banks; currently, it is assumed that they will be recovered
>
> - Bank of England run schemes indemnified by central government, such as the special liquidity scheme .., are only regarded as having a permanent effect when there is an impact on the central government finances
>
> The main class of interventions regarded as temporary, in line with the third principle, are those relating to the public sector banks ... Their designation as temporary reflects the government's intention to return these banks to the private sector and to divest itself of shareholdings in these banks. This means that, when calculating PSNB ex and PSND ex, these institutions are treated as though they were outside the public sector."

[17] http://www.ons.gov.uk/ons/rel/psa/public-sector-finances/including-finance-lease-liabilities-in-public-sector-net-debt--pfi-and-other/public-sector-finances-excluding-financial-interventions.pdf

Extract 2

"The Bank of England established two schemes (the asset purchase facility and the special liquidity scheme) to provide liquidity in response to the financial crisis. Both schemes are indemnified against losses by central government. The eventual losses or profits generated by the scheme will have a permanent effect on PNSB ex and PSND ex. In the meantime, given the uncertainty about the size and direction of any permanent effect, the effects from both schemes are regarded as temporary.

Extract 3

"The BEAPFF also contributes to PSND (and PSNB) by way of its net interest income, the difference between its receipts of interest from the issuers of the bonds (mainly government) and the interest paid to the Bank of England on the loan used to finance the purchase of assets by the fund.

The assets acquired by the BEAPFF will, in time, be sold back to the market. Any shortfall will be made up by central government while any profit on closure of the scheme will be retained in the public sector. It is at this point that the effect of the scheme will be regarded as permanent. The current effects are regarded as temporary and excluded from both PSND ex and PSNB ex."

The Treasury Statement of 9 November 2012

On 9 November 2012, the Treasury announced[18] that the Government had agreed with the Bank of England to transfer to the Exchequer the excess cash held in the Bank's Quantitative Easing (QE) facility. The statement included the following paragraphs:

"Since 2009 the Bank of England has operated QE by buying gilts and holding them in a dedicated facility called the Asset Purchase Facility (APF). These gilts attract regular coupon payments from the Exchequer. With the purchases of the APF having reached £375 billion, this Facility has now accumulated a large cash balance. As the scale and likely duration of the scheme has increased significantly since its inception, it makes sense to normalise the cash management arrangements for the APF.

From now on this excess cash will be transferred to the Exchequer on a regular basis. This will improve transparency and align our practices with those of major central banks like the United States Federal Reserve and the Bank of Japan.

These changes will end the current arrangement which requires the Government to borrow money to fund coupon payments to the Bank of England. Holding large amounts of cash in the APF is economically inefficient as it requires the Government to borrow money to fund these coupon payments.

At some point in the future, as monetary conditions normalise, it is likely that the cash flows will need to be reversed. Return payments from the Government to the APF may be necessary to meet shortfalls in the APF's net income as the Bank Rate rises, or capital losses on its gilt holdings as the Monetary Policy Committee unwinds QE. The previous Government agreed that any future losses incurred by the APF will be met in full by the Government. For this reason, any net coupon income transferred from the APF to the Exchequer should be used solely to pay down government debt."

[18] http://www.hm-treasury.gov.uk/press_109_12.htm

The ONS Classification Statement and Article of 21 February 2013

In a statement[19] on 21 February 2013, ONS explained the background and said:

> "In Public Sector Finances statistics, the BEAPFF is treated as a temporary effect of the government's financial interventions and is therefore excluded from the headline measures of Public Sector Net Borrowing (PSNB ex) and Public Sector Net Debt (PSND ex), which exclude any temporary effects of financial interventions. This means that the interest payments on these gilts continue to increase PSNB ex and the face value of the stock of gilts continue to be included as a government liability within PSND ex."
>
> And
>
> "Following recommendations from the National Accounts Classification Committee (NACC), The Public Sector Finances Technical Advisory Group (PSFTAG) and Eurostat, it has been decided that:
>
> - The Asset Purchase Facility will continue to be treated as part of the Bank of England in National Accounts and Public Sector Finance statistics.
> - The flows of cash from the BEAPFF to HM Treasury, up to the level of the combined Bank of England's 'Entrepreneurial Income' from the previous year, are treated as final dividends and therefore reduce the level of General Government Net Borrowing by that amount. However, anything above this level will be treated as a special transaction in equity, known as a super-dividend, which will not impact on the level of General Government Net Borrowing. (This calculation is known as the super-dividend test.) Whatever the impact on General Government Net Borrowing, the full value of the payments will impact on the General Government Net Cash Requirement.
> - Any flows of cash from HM Treasury to the Bank of England in the future to cover losses made by the BEAPFF will be treated as Capital Transfers and so will impact (in the opposite direction) on measures of General Government Net Borrowing and General Government Net Cash Requirement.
> - The BEAPFF as a whole should remain classified as a temporary effect of financial interventions as the end state of the BEAPFF remains unknown.
> - The payments between the Bank of England and Treasury should be treated as permanent effects and therefore impact on the headline measures of Public Sector Net Borrowing (PSNB ex) and Public Sector Net Debt (PSND ex), which exclude temporary effects of financial interventions."

Alongside this statement, ONS published a Classification Article[20] which gave more detail on the decisions outlined above. In relation to the treatment of the payments to the Treasury (the final bullet point above), the article states:

> "These recommendations were based on published criteria[21] for temporary or permanent effects of financial interventions. An important part of the rationale for the

[19] http://www.ons.gov.uk/ons/media-centre/statements/treatment-in-official-statistics-of-the-cash-transfers/index.html?format=print

[20] http://www.ons.gov.uk/ons/guide-method/classifications/na-classifications/classification-articles/changes-to-cash-management-arrangements/index.html

[21] These are the criteria included in the March 2010 note discussed under the heading 'The relevant guidance' above.

recommendations was the statement in the published criteria that “Bank of England run schemes indemnified by central government…are only regarded as having a permanent effect when there is an impact on the central government finances.” In the case of the BEAPFF (which is indemnified by central government), there is no direct impact on central government finances by its day to day operations, in which it purchases assets from the private sector (mainly gilts) and manages those assets. Therefore, the BEAPFF itself can be seen as a temporary effect of financial interventions. However, the new cash flows between the BEAPFF and HMT clearly have an impact on the central government finances and as such these flows can be seen as permanent effects of financial interventions.”

And

“The view of PSFTAG on treating the flows as permanent effects was further informed by desire for consistency of treatment with other financial interventions. An example of this is the treatment of fees paid to HMT by public sector banks under the credit guarantee and asset protection schemes. The fees from the public sector banks into central government are treated as permanent (and so included in PSNB ex and PSND ex) when they occur even though they originate from bodies deemed to be temporary effects of the financial interventions. Under the published criteria any guarantee payouts by government would similarly be treated as permanent effects. This treatment is analogous to that for the cash flows from and to the BEAPFF.”

Annex 3: Terms of reference

UK STATISTICS AUTHORITY

Group to review the issues surrounding decisions on the Asset Purchase Facility

Terms of Reference

Introduction

1. The Chancellor of the Exchequer announced on 9 November 2012 that it had been agreed to transfer to the Exchequer the excess cash in the Bank of England Asset Purchase Facility Fund (BEAPFF).
2. The Office for National Statistics (ONS) published on 21 February 2013 a classification decision on these cash transfers, including their treatment in the Public Sector Net Debt and Public Sector Net Borrowing excluding the temporary effects of financial intervention (PNSD ex and PSNB ex).
3. This classification decision was the subject of correspondence between Mr Chris Giles[22] and the Chair of the UK Statistics Authority, which was published on the Authority's website. In his letter[23] of 21 March 2013 to Mr Giles the Chair of the Authority set out how the Authority had decided to review the issues surrounding the decisions on the Asset Purchase Facility, and how the Authority expected to publish a report before the end of May.
4. At the request of the Authority Chair an outline for such a review was drafted by Mr Alldritt and the outline was endorsed at a meeting of the Authority's Assessment Committee on 21 March 2013. The outline described how a group would be formed to conduct the review. The outline is attached to this document.
5. The review group would be known as the Asset Purchase Facility Review Group (APFRG).

Role, Responsibilities and Reporting

6. The role of the APFRG is to review the treatment in the Public Finance Sector Statistics produced by ONS of changes to the cash management arrangements between the BEAPFF and HM Treasury, consistent with the outline document agreed by the Authority Chair.
7. The focus of the review is on a) the recommendation by the Public Sector Finance Technical Advisory Group (PFSTAG) and b) the process by which decisions of the kind that are currently considered by the PFSTAG are taken. The scope and remit of the group is further defined by the outline document.
8. Consistent with the commitments described in the Chair's correspondence and the outline document, the group is responsible for producing a draft report for consideration by the Chair and Board of the UK Statistics Authority by the end of May 2013.

Membership

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[22] http://www.statisticsauthority.gov.uk/reports---correspondence/correspondence/email-from-chris-giles-to-andrew-dilnot---28022013.pdf

[23] http://www.statisticsauthority.gov.uk/reports---correspondence/correspondence/letter-from-andrew-dilnot-to-chris-giles---21032013.pdf

9. The members of the group are:

- Mr Partha Dasgupta, Chair of the group;
- Professor Sir Tony Atkinson, external expert member of the group;
- Mr Richard Alldritt, member of the group with lead responsibility for producing a draft of the group's report;
- Mr Sandy Stewart, providing support to Mr Alldritt as a member of the Monitoring and Assessment Team; and
- Mr Robert Bumpstead, providing secretariat and support to the Chair of the group.

Meetings and quorum

10. The group will meet at the request of the Chair convened by the secretariat.
11. Meetings of the group will be considered quorate if the Chair, Professor Atkinson, Mr Alldritt and one other member are present.

Secretariat, April 2013

OUTLINE FOR AN INVESTIGATION BY UK STATISTICS AUTHORITY

The treatment in Public Sector Finance Statistics of Changes to Cash Management Arrangements between the Bank of England Asset Purchase Facility Fund and HM Treasury

This investigation is prompted by concerns expressed to the UK Statistics Authority about the way a change in cash management arrangements between the Bank of England and HM Treasury is to be reflected in the fiscal measures 'PSNB ex' and 'PSND ex'. An email from Chris Giles of the Financial Times to the Chair of the Statistics Authority is attached along with a technical article published by the Office for National Statistics on 21 February 2013 which sets out the background to the ONS decision.

The focus of the investigation will be on a) a recommendation by the Public Sector Finance Technical Advisory Group (PSFTAG, a committee chaired by ONS and composed of government statisticians), and b) the process by which decisions of the kind that are currently considered by PSFTAG are taken. The specific recommendation was "**firstly that the BEAPFF as a whole should continue to be treated as a temporary effect of financial interventions. Secondly, ... that the cash flows between the Bank of England and Treasury should be treated as permanent effects and therefore (in accordance with the super-dividend test) impact on the headline deficit measure (PSNB ex).**" The investigation will consider all relevant background including the guidance and criteria followed by the committee in deciding its recommendation and, more generally, the process for taking those decisions of which this recommendation is one specific instance.

The investigation will result in a report to the Board of the Statistics Authority, with a view to subsequent publication.

The review team will comprise [Professor Sir Tony Atkinson], Partha Dasgupta, member of the Board of the UK Statistics Authority and Richard Alldritt, Head of Assessment, UK Statistics Authority. The review team will be supported by Sandy Stewart of the Monitoring and Assessment Team of the Statistics Authority.

The investigation will be conducted as follows, subject to any changes made following preliminary discussion by the review team:

- Background papers to the decision will be obtained and made available to the review team. This will include the papers considered by the PSFTAG, all relevant guidance materials, and any relevant correspondence between officials in ONS and the Bank of England and between ONS and HM Treasury.

- A preliminary meeting of the review team will take place to consider the documents and identify the points requiring further investigation.

- A meeting will then be arranged between the review team, the chair of PSFTAG, and any other official nominated by the National Statistician, to explore the issues.

- A draft report will be prepared under the management of the Head of Assessment and a final meeting will take place of the review team to finalise and agree the report before it is submitted to the Board of the Statistics Authority. The arrangements for publication will be decided by the Board.