The difficulties attached to the collection of information on households' holdings of securities: third-party reporting

Carlos Sánchez Muñoz and Jean-Marc Israël[1, 2]

Introduction

Households account for a significantly more modest share of securities holdings than institutional investors do. However, according to official statistics securities holdings may represent a significant proportion of households' financial assets, thus reflecting a considerable part of the overall households' wealth. The general difficulties attached to the direct collection of data from households are substantially more acute in the case of data on securities holdings, especially if securities are deposited in custody outside the compiler country. This presumable data gap may translate into a likely underestimation of households' wealth of uncertain magnitude.

The appetite for holding securities is also unequally distributed across different wealth strata of the household population, as it is usually largely concentrated with high-worth individuals. Precisely in the upper tail of the population of households, investors are more likely to resort to the financial services provided by non-resident custodians/depositories sometimes for tax opacity reasons. This adds to the complexity of getting access to reliable data.

Following from this finding, the paper is in three sections. The first section describes the reasons why securities holdings by households are deemed to be underestimated, provides some (limited) empirical evidence on the presumable gap and briefly elaborates on why the gap may somewhat distort some economic analyses. The second section explores how the exchange of data across countries could help fill the gap; describes the main potential problems; argues about the reasons why such an initiative (which is by no means a new idea) could be more successful in the future than it has been so far; and finally provides details about how the exchange could be set up. The third section concludes.

1. The issue

1.1 Difficulties to collect data on securities holdings by households

The collection of statistical information corresponding to the household sector is not an easy task. Due to the dispersion of the household population, the inclusion of households in the population of direct reporters is neither cost-effective nor practical. Consequently, information on households' holdings is usually obtained from domestic custodians and institutional investors, who report on securities holdings and transactions on behalf of their customers.

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[1] The views expressed in this paper are those of the authors and do not necessarily represent those of the ECB. European Central Bank, Directorate General Statistics, Kaiserstrasse 29, D-60311 Frankfurt am Main; Germany. E-mail: carlos.sanchez_munoz@ecb.int, jean-marc.israel@ecb.int.

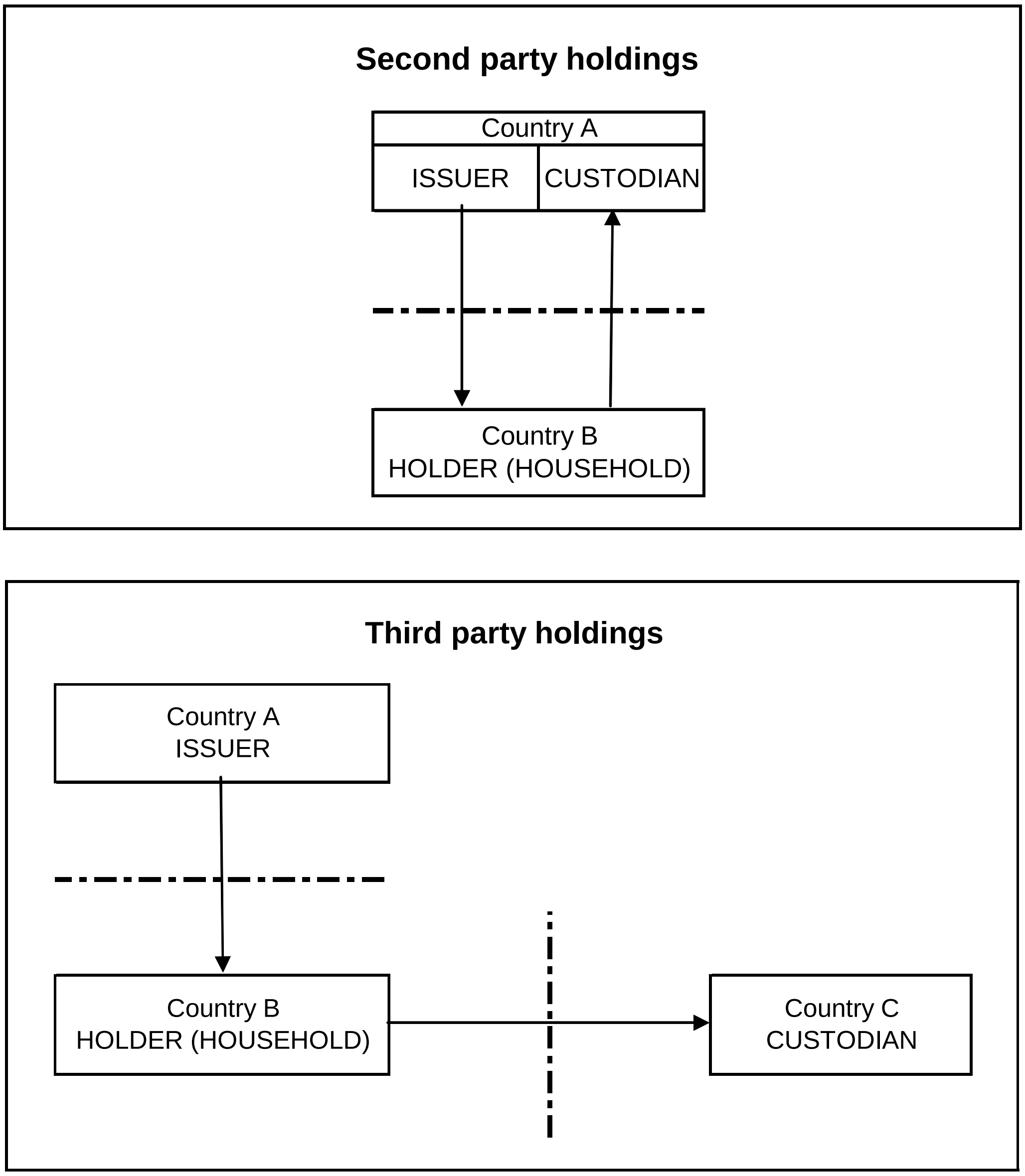
[2] The authors gratefully acknowledge the valuable comments provided by S. Keuning, P. Sandars and S. Duverger.

While these information sources provide fairly accurate data on securities acquired through domestic institutional investors, and/or deposited with domestic custodians, data on acquisitions in foreign markets through non-resident financial intermediaries and securities deposited with foreign custodians are more difficult to collect by the compilers of statistics.

When households entrust securities to a non-resident custodian, two different situations may appear (see chart 1): (i) the so-called "second-party holdings" occur when the securities are deposited with a custodian located in the same country as the securities' issuer; (ii) conversely, on "third-party holdings" investors select a custodian located in a country other than that from which securities originate.[3]

Chart 1

Modalities of securities holdings deposited abroad



[3] As will be seen in the next section, the legal entitlement of the statistical compiler of the country in which the custodian is located to collect these data may be substantially different in the case of second- and third-party holdings, respectively.

The compiler of statistics in country B (the country of residence of the household) is not legally entitled to collect information from non-resident entities (eg from the foreign custodians). As a result, the total securities holdings of the household sector may be considerably underestimated.[4]

1.2 How sizeable is the gap?

In 2001, the IMF Committee on Balance of Payments Statistics set up the Working Group on Third Party Holdings (WG TPH) to explore avenues for measuring holdings by residents of securities entrusted to non-resident custodians.[5] While assessing the size of the gap is a difficult task, its potential significance was confirmed by the evidence collected by some euro area countries (France, Germany, Italy, and Netherlands) in the context of the WG TPH. The information only covered second-party holdings.[6]

The US Federal Reserve collected further evidence from the private banking units of a sample of three major US banks (also focusing only on second party holdings). The information suggested that non-resident household holdings of US securities were in the order of 1-2 per cent of the total US securities held by non-residents.

Last but not least, according to Swiss National Bank publications the total value of securities held in custody accounts by Swiss banks on behalf of non-resident non-institutional investors amounted to about USD 530 billion as at end-December 2005.[7]

1.3 Does it matter?

In globalised economies with considerable cross-border capital flows, assessing the actual holdings of wealthy households may not appear as a top priority. However, when dealing with global imbalances, also taking into account key variables such as increasingly rapid changes in asset prices and saving ratios, assessing the actual income and wealth of households may significantly affect the picture and the analysis at the time of assessing the sustainability of specific economic developments.

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[4] In fact, all securities held in custody abroad (ie by any resident investors) could be underestimated if only domestic custodians' reports were used. However, information on holdings by institutional investors (banks, collective investment institutions, large non-financial corporations, etc) is typically easier to collect directly from such investors. Consequently, the problem is mostly relevant for the household sector.

[5] In the context of work related to the annual Coordinated Portfolio Investment Survey, ie data reported to the IMF by countries on the holdings by domestic investors of securities issued by other countries broken down by issuer country. An annual exchange of this aggregated information amongst participating countries has proved to be a powerful tool to get mirror data on countries' portfolio liabilities, which are especially difficult to capture by other means. One of the main weaknesses of such portfolio assets precisely concers the securities deposited by resident households with foreign custodians.
The WG TPH met once in Frankfurt in 2004 and initiated a feasibility study in 2005, which has not yet been concluded.

[6] Holdings of domestically issued securities by non-resident households (see Chart 1).

[7] Swiss National Bank (2006).

2. Is there any way to fill the gap?

2.1 Third-party reporting as a possible solution

As mentioned in the introduction, collecting information directly from households is not cost-effective, while the necessary information is not available to any other domestic reporters (financial intermediaries) that could more easily provide it on behalf of households. Consequently, alternative methods need to be considered. In this regard, the only feasible alternative seems to be that the necessary information is collected by third parties, namely the statistical compilers of the jurisdictions where custodians are located and be regularly exchanged on a reciprocal basis (in the same fashion as the annual CPIS quoted under footnote 5).

While it could be argued that the reporting burden for custodians in some countries could be substantially increased, in many circumstances reports may be automated. For instance, in those countries where custodians report on a security-by-security basis they could simply be required to transmit the raw (disaggregated) data on all securities held in custody (identifying securities held by individuals), thus transferring the bulk of the processing burden to compilers. As compilers typically possess the tools to manage the data in a more or less automated way, their additional burden may not be so high.

2.2 Potential problems to be overcome

Legal entitlement to collect the data and exchange them with counterpart countries: in some countries national legislation does not allow compilers of statistics to collect data unless it is strictly and directly (ie not through any kind of reciprocal exchange with other countries) usable for their own statistics. Consequently, while second-party holdings may often be collected without legal restrictions (being part of the liabilities of the country where the custodian is located), third-party holdings may pose more difficulties. Therefore, either the introduction of changes in the national legislation or a supra-national piece of legislation would be required. As to whether compilers could also find legal restrictions to exchange statistical information with other countries, it seems that, as long as appropriate measures are taken to prevent the exchange of confidential data,[8] no legal impediments should exist.

Identification of end investors: when the securities accounts are opened by legal entities representing third parties (for instance, households), custodians may have difficulties to trace the ultimate investors. This is the case of portfolios managed by trusts or accounts opened and operated by asset managers on behalf of final investors. There is hardly any quantification of the importance of the problem.

Re-distribution of the reporting and compilation burden across countries: a considerable difficulty may be the imbalance between costs and benefits across countries. Indeed, a large share of worldwide securities are held in custody in countries which are not significantly affected by the problem, ie in the event of a reciprocal exchange they would obtain a modest gain from the information to be delivered by counterpart countries compared with the significant effort implied due to their importance in the custody business.

Business concentration: it appears that retail banking for individuals is often much less concentrated than the services provided to large institutional investors,[9] thus adding to the difficulties to collect the necessary data.

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[8] Only aggregated information on the household sector of each national jurisdiction is needed.

[9] Small, R.A. (1999).

Other statistical difficulties: eg ***double counting due to repo-type deals:*** it is commonly assumed that securities deposited by high worth individuals with foreign custodians are unlikely to be frequently subject to securities lending or repurchase agreements. Consequently, the risk of overestimation of households' wealth (as a result of double-counting securities lent/repoed and cash received in exchange) appears to be fairly modest.

2.3 Why could a revival of this initiative be now more successful than in the past?

As explained in the introduction, the idea of a reciprocal exchange of information amongst countries is not a new one. In addition to the IMF WG TPH, in 2002 the ECB Task Force on Portfolio Investment Collection Systems (TF-PICS) recommended to its parent committee (the ECB Statistics Committee) considering the feasibility of an annual third-party reporting scheme for securities held by households.[10]

While such initiatives have helped raise awareness about the importance of the gap, they have not yet yielded results to date. However, latest developments in the European Union and in major counterpart countries may add further impetus to such an initiative.

Currently, security-by-security data collection methods (which, as explained above, significantly ease the reporting by custodians) have been, or are being, introduced by all euro area countries. In addition, NCBs in the European Union have managed to set up the so-called Centralised Securities Database (CSDB), ie a powerful database with comprehensive information on worldwide individual securities, which is already being used to compile statistics.[11] In the future, the CSDB may also store some information on securities holdings, which would pave the way for a regular exchange of information across European Union countries.

Outside the EU, in 2005 the Federal Reserve System of the United States, which also collects security-by-security information via annual surveys, took the initiative to extend its portfolio investment liabilities survey so as to identify "foreign individuals" covering for a possible future reciprocal exchange of such data with counterpart countries. Additionally, the Legal Department noted that the current legislation in the United States is sufficient to collect third party holdings, provided there is a quid pro quo from other countries to supply the United States with comparable information.

2.4 How to set up the exchange

Given the frequency of custody surveys, a cross-country data exchange could take place on an annual basis. Most confidentiality issues could be overcome if the data were collected in a form that did not allow the identification of the securities holders, ie the data could be conveniently aggregated (eg by counterpart countries, security classes, etc) before being exchanged.

Along these lines, it would seem advisable that a central party takes care of the necessary aggregation of mirror data corresponding to each counterpart country. Given the role of the

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[10] ECB (2002). The TF PICS considered the feasibility of a comprehensive third-party reporting scheme (ie not limited to households' holdings) across European Union countries. The study led to the conclusion that, while an all-encompassing scheme would be too difficult to set up (due to, inter alia, the risk of double-counting in the case of long custody chains), an annual third-party reporting scheme for securities held by households deserved further consideration. The TF-PICS noted the need to widen the scope of any such scheme to securities deposited in custody outside EU countries, ie the scheme should also consider exchanges with counterparties outside the EU to the extent possible.

[11] ECB (2006).

IMF in the current annual exchange of data through the CPIS, it could stand to reason that the IMF also sets up and manages a central database with the information provided by participating countries. The ECB (possibly linked to the maintenance of the CSDB) could take care of information referring to euro area countries. The data could comprise securities held by non-resident individuals broken down by the country of residence of the issuer and the holder, without any information on the country where the securities are held in custody, ie avoiding the disclosure of sensitive information to the extent possible.

3. Conclusions

The general message of this paper is that households' wealth may be substantially undervalued as a result of the difficulties to get access to reliable measures of securities entrusted by households to foreign custodians.

Given the traditional difficulties attached to the direct collection of statistical data from households, some kind of indirect collection appears necessary. Given the constrains to collect this information from non-resident reporters, the most promising solution seems to be that countries where custodians are located collected information on (both second- and third-party) holdings by non-resident households and exchange it with counterpart countries on a reciprocal basis.

While the difficulties attached to the proposal (and described in the paper) should by no means be underestimated, trying to cover this gap may be worth the effort, especially because no serious alternative exists at this stage.

In the case of the European Union countries, the CSDB may offer an invaluable platform for the exchange of information on securities holdings by high wealth individuals in the future. Yet, widening the scope of such an exchange to jurisdictions elsewhere (and especially to those countries with the largest share of the custody business) would undoubtedly increase the analytical value of the results.

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