



Irving Fisher Committee on
Central Bank Statistics

BANK FOR INTERNATIONAL SETTLEMENTS

IFC Satellite meeting at the ISI World Statistics Congress on *"Assessing international capital flows after the crisis"*

Rio de Janeiro, Brazil, 24 July 2015

Residency and Nationality: A view from 10,000 feet¹

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¹ This presentation was prepared for the meeting. The views expressed are those of the author and do not necessarily reflect the views of the BIS, the IFC or the central banks and other institutions represented at the meeting.

Residency and Nationality: A view from 10,000 feet

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Session 3: Should residency-based data be completed by nationality information?

Residency: The legal definition

Residency means you have a presence with a purpose. When you complete that purpose, you will return to your domicile. It is distinct from domicile which needs no purpose. In addition, a person can simultaneously have several residences but only one domicile.

Residency: The BOP definition

The residence of each institutional unit is the economic territory with which it has the strongest connection, expressed as its center of predominant economic interest. Each institutional unit is a resident of one and only one territory. Corporations and nonprofits normally are expected to have a center of economic interest in the economy in which they are legally constituted or registered. This may be different than the economies of their shareholders, subsidiaries or parent corporation.

Why residency (or location) matters

- Physical proximity and the associated cultural similarities mean that, for most, the predominance of one's economic interactions are with fellow residents.
- Physical proximity means that residents are subject to common external shocks.
- Owing to self-interest or cultural affiliation private agents may act for the benefit of residents over non-residents.
- Residents elect governments and governments give policy makers their mandates. The end result is that policy makers are instructed to act for the benefit of their fellow residents.
- Through the legal system, policy makers have their most direct influence over residents.

What residency really gets us:

- Positive correlation of outcomes among fellow residents
- A marker for who controls resources and for whose benefit those resources will be directed—fellow residents
- Very useful and precisely what we need to assess financial stability

Residency can also be misleading or, at least, uninformative

- Cayman financing vehicle: No interaction with other Caymanians
 - => Little correlation
- Apple Computer's subsidiaries in Ireland
 - Some have significant interaction with Ireland, but low correlation
 - Control of the Apple resources in Ireland
 - US Authorities rival those of host Ireland
 - US Parent-Apple will direct them for the benefit of Parent-Apple, not necessarily Ireland

Two alternatives/complements to residency:

- Ultimate Risk: Who is on the hook for an obligation if all the more immediate obligors do not perform.
 - Particularly useful for guarantees written by third parties, e.g., CDS
- Nationality: Cross-border parent-subsidiary relationship based on the notion of control.
- But these two can be conflated.

Guric and Wooldridge (2012) on Nationality

- *The BIS has...published [debt] ...statistics broken down by...the nationality...of the issuer...even though the [Handbook on Security Statistics] provides no guidance for such a classification. Nationality refers to the ultimate obligor, as opposed to the immediate borrower on a residence basis...Information on a nationality basis is useful to analyse potential support that might be available from the parent company and to understand links between borrowers in different countries and sectors...Consistent with the approach taken in the international banking statistics, the BIS bases the nationality of an issuer on the residency of its controlling parent, regardless of any intermediate owners.*

Claim is that from Controlling Parent you can get

- Ultimate Obligor
- Source of potential support
- Ownership

What does Controlling Parent really get you?

- *Ultimate obligor?* Not unless there are explicit guarantees
 - The reason to organize a sub with a limited liability structure is precisely so the parent does not need to support the child in all situations.
- *Source of potential support? Who supports whom?*
 - Sometimes the parent supports the child
 - Sometimes the child supports the parent
 - Sometimes the child is left on its own
- *What we know for sure:* The parent and its supervisors are not going to give as much weight to the child's well being (or fellow residents) as a fully domestic firm would

Neither Residency nor Nationality gives a clear picture

- But they work well together when we know what we are looking for
- E.g., Classic financial stability question: “What is my exposure to X?”
 - As a first pass, all I care about is an upper bound.

Getting an upper bound on exposure

- First go to the residency data and find direct exposures to all residents of X.
 - Along with nationals of X, this includes foreign subs operating in X.
 - Including these subs is saying there will be no support from the parent.
 - Its's okay, we are looking for an upper bound
- Next, add in exposure to non-X subs whose parents are resident in X. (E.g., offshore financing arms of Chinese firms)
 - Assumes the Chinese parents will not support them
- All good for getting an upper bound on exposure.....But,

Even working together Residency and Nationality will miss indirect exposure

- That is, my exposure to a non-X firm that itself has exposure to X?
 - Neither Residency nor Nationality will pick this up
- For most sectors, probably not worth the collection effort
- For where it is most important, BANKING, we already have it in the *consolidated* statistics
 - That's for another session

Thank you