

## **CMFB opinion**

### **concerning statistical accounting consequences for government of the financial turmoil**

1. At Eurostat's request the CMFB Chairman, with the assistance of the CMFB Executive Body, asked the CMFB Members on 11 February 2009 to state their opinion by 25 February 2009 on statistical accounting consequences for government of the financial turmoil. Nineteen (19) national statistical institutes and twenty (20) national central banks from the EU Member States returned the questionnaire within the specified time. A total of thirty-nine (39) national institutions responded to the questionnaire. The ECB also provided its opinion.
2. The results of the consultation are as follows:
  - 2.1. Based on the replies received, there was no clear majority view on whether or not a sufficient condition for consolidating a new financial body (as described in Annex 1) with an existing institutional unit would be that the new financial body was created to execute specific tasks in the context of financial rescue operations and its activities are pre-determined by the existing institutional unit.

*The CMFB, therefore, does not express a preference for either of the two options.*

- 2.2. Based on a very large majority of the replies received, it is the opinion of the CMFB that:

*A financial body in which non-government units hold a majority stake and which is considered as a separate institutional unit, should be classified within the general government sector under a limited set of conditions.*

The CMFB considers the following set of conditions as the most appropriate (see also Annex 2):

- *if the institutional unit administers and finances a group of activities that principally provide non-market goods and/or services, intended for the benefit of the community,*
- or
- *if the government (a) pre-determines the body's activity and (b) assumes all or a majority of the risks associated with the body's activities, perhaps through the granting of a guarantee which covers all or most of its financing.*

- 2.3. Based on a large majority of the replies received, it is the opinion of the CMFB that:

*In addition to the circumstances explicitly set out in the ESA95, rescue operations undertaken by public corporations classified outside general government should be subject to re-arrangement through the government accounts under a limited set of other circumstances.*

The CMFB, furthermore, considers the following condition as the most appropriate:

- *the existence of a written instruction (or other form of irrefutable evidence) of the government requiring the public corporation to carry out the operations.*

- 2.4. Based on a very large majority of the replies received, it is the opinion of the CMFB that:

*An exceptional loss made by a financial institution should not mean that any subsequent government injections into that corporation in the form of unquoted equity should be treated as a non-financial transaction up to the amount of the exceptional loss. The exceptional loss is not*

*relevant - a capital transfer is only recorded if the expected rate of return is deemed insufficient under the EU State Aid rules.*

- 2.5. Based on a large majority of the replies received, it is the opinion of the CMFB that:

*The steps recommended for the valuation of recapitalisation and the purchase of assets and defeasance, as presented in the background document (see Annex 3 of this opinion, and the recommendation concerning step 6 expressed in Annex 2 of this opinion), should be applied under the conditions of financial turmoil.*

3. Further details on these accounting treatments are provided in the background document prepared in support of this CMFB consultation.
4. The CMFB acknowledges that the continued innovation by the authorities in response to evolving circumstances may give rise to further questions on the appropriate statistical accounting consequences for government.
5. This opinion has been transmitted to Eurostat and will be kept in the records of the CMFB secretariat.

*(Signed)*

Peter van de Ven  
CMFB Chairman

Den Haag, 18 March 2009

## **Annex 1**

The question relates to new financial bodies set up jointly by governments and non-government parties, or by non-government parties themselves with government support that have particular legal characteristics (for example a trustee arrangement), which means that they are “off the commercial balance sheet” of the nongovernment owners. If these bodies have a very restricted and largely pre-determined<sup>1</sup> activity (perhaps as a special purpose entity<sup>2</sup>), then they could be considered as not demonstrating the characteristics of institutional units and be classified to the sector of the unit which controls them. Thus, if they are controlled by government, these bodies would therefore be classified into the general government sector in national accounts.

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<sup>1</sup> The predetermination of activities may be linked to the controlling unit having a right of veto on all decisions made by the newly created body.

<sup>2</sup> This term has been introduced in the SNA 2008, and the situations under which these types of bodies may be identified and classified is extensively discussed. However, no such guidance exists in ESA95 or SNA 1993.

## **Annex 2**

### **Comments**

Regarding the set of conditions specified in paragraph 2.2, some CMFB members considered that condition (a) or condition (b) would be sufficient by themselves.

With regard to "*Rescue operations undertaken by public corporations classified outside general government should be subject to re-arrangement through the government accounts under a limited set of circumstances*" in paragraph 2.3, the CMFB opinion applies to the case of "rescue operations" such as those observed during the financial turmoil. Furthermore, it was noted that in the specific case of Central Bank liquidity operations, these operations would generally fall within the Central Bank's existing remit to preserve financial stability, and should therefore not be re-routed through government.

Regarding the condition specified in paragraph 2.3, most replies advocated that a written instruction (or other form of irrefutable evidence) of the government requiring the corporation to carry out the operations would be the most appropriate condition. A smaller number of replies indicated that this was a necessary condition in combination with the condition that "*the operations are undeniably against the economic interests of the public corporation carrying out the operations*".

Regarding step 5 of *the valuation of recapitalisation and the purchase of assets and defeasance* in paragraph 2.5, some CMFB members noted the difficulties for compilers to analyse whether the market conditions are similar at the time of sale or revaluation to the time of the original purchase and, moreover to establish the exact meaning of 'similar conditions'.

Furthermore, some reservations were expressed in relation to step 6. This step does not reflect that economic conditions may be different at the time of the two transactions and, as a consequence, changes in valuation (holding gains/losses) due to changes in market conditions may be recorded as capital transfers. It was also noted that cases of write-off should not be recorded as 'other changes in volume' in this context. Furthermore, step 6 is not time limited. Because of the reservations expressed, the CMFB recommends that the conditions, under which this step is to be applied, be reconsidered.

## Annex 3

### **Steps to the general approach to valuation of securities other than shares**

Step 1. Is the market adequately operating? Examples of features which would indicate this are a balance of buyers and sellers, market clearance, sufficient market volumes to establish a market price, smoothly evolving prices and/or an absence of large bid/offer spreads.

If yes, the appropriate valuation is the market value. If no, continue to step 2.

Step 2. Is the conduct of the transaction undertaken in such a way as to determine a market value? An example of this would be a conventional auction with many bidders.

If yes, the amount paid is considered to be a market value. If no, continue to step 3.

Step 3. Is the price paid greater than the carrying value of the asset in the business accounts of the seller? The conditions for this step are that the carrying value should be based on suitable business accounting principles and should correspond to a point in time reasonably close to the time of the transaction.

If yes, impute a capital transfer for the difference between the price paid and the book value.

If no, but the conditions set out above for step 3 are met, the amount paid is considered a market price. If these conditions are not met, continue to step 4.

Step 4. Is the price paid based on a demonstrably independent valuation founded on a market-based technique, or is at or close to a recent (possibly average) price observed in an adequately operating market for the same or very similar securities?

If yes, the price paid is considered to be a market value.

If no, provisionally record the price paid as equivalent to the market value, then continue to step 5.

Step 5. Has the asset been sold or re-valued in the year following the transaction?

If yes, analyse to see if the sale value can be considered as arising from a market under similar conditions as the original purchase, or if the accounting revaluation makes an assumption of markets under similar conditions as the original purchase. If this is the case, impute a capital transfer (at the moment of sale or revaluation) where the sale or new carrying value is lower than the original payment to purchase the asset.

If no, keep the existing recording from step 4 above.

Step 6. Has the asset been sold at a later stage following the transaction?

If yes, and if steps 3-4 above were used to determine the initial value at time of purchase, compare the sale value with the original purchase price of the assets. Where the original price paid was higher, impute a capital transfer for the difference at the time of sale.

If no, keep the existing recording from steps 1-4 above.