

CMFB opinion
concerning statistical accounting consequences for government of the financial turmoil
UK's "Special Liquidity Scheme"

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 on the statistical accounting consequences for government of the UK Special Liquidity Scheme with a deadline of 25 February 2009. Eighteen (18) national statistical institutes and twenty (20) national central banks from the EU Member States returned the questionnaire within the time specified. A total of thirty-eight (38) national institutions responded to the questionnaire. The ECB also provided its opinion.
2. The CMFB considered first whether the provision of securities by the UK government to the Central Bank under the Special Liquidity Scheme should be recorded as stock-lending with no cash, i.e. with no increase of government debt, or as an issue of government securities, and their subsequent purchase by the central bank, thereby increasing government debt. There was no clear majority view in favour of either option.

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

3. The CMFB then considered whether the exchange of assets between the UK Central Bank and banks participating in the Special Liquidity Scheme should be recorded as back-to-back repos or as stock-lending with no cash.

Based on a large majority, it is the opinion of the CMFB that

– *the exchange of assets between the UK Central Bank and banks participating in the Special Liquidity Scheme should be recorded as stock-lending with no cash.*

4. Further details on these accounting treatments are provided in the Annex to this opinion and in the background document prepared for this CMFB consultation.
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

Comments

A.1 For this consultation, the CMFB considered two issues, namely (i) operations between the government and the Central Bank, and (ii) operations between the Central Bank and the banks participating in the Special Liquidity Scheme. Although both issues are interrelated (see background document), the two legs of the Special Liquidity Scheme were considered separately.

A.2 As regards the CMFB opinion in paragraph 2, it was noted in support of the recording of securities provided by the UK government to the Central Bank under the Special Liquidity Scheme as stock-lending with no cash, that the prevailing statistical guidance for securities lending without a flow in cash is that the securities should remain on the balance sheet of the lender as there is a firm commitment for the reverse transactions. Securities lending with no flow of cash collateral is therefore to be recorded as an off-balance sheet transaction. Since there is no cash collateral, apart from the service fee, the economic ownership remains unchanged and therefore there should be no impact on the consolidated government debt.

Furthermore, it was noted that, in essence, the Special Liquidity Scheme can be seen as a way of designing a government guarantee for interbank liquidity. The financial implications of a guarantee should only be recorded when/if called. An impact on government debt only occurs when the Central Bank is not able to return the borrowed securities in due time, due to defaulting banks. In such a case, claims of the Central Bank on defaulting banks would not materialise because of default (matching "other change in volume") while claims of the government on the Central Bank would materialise at the same time and be offset by a capital transfer to enable the purchase of securities on the market by the Central Bank. In turn, this would increase government deficit and debt.

A.3 In favour of recording the provision of securities by the UK government to the Central Bank under the Special Liquidity Scheme as an issue of government securities, which are subsequently purchased by the central bank, it was noted that the operation described does not appear to be 'stock-lending' as envisaged in the existing methodological manuals. Standard securities lending arrangements usually expire within a fortnight while this operation may last for 3 years and, in particular, the lending of own securities by the government and the existence of a government guarantee for losses under the "Special Liquidity Scheme" (SLS) seem to be very specific and have unusual features. The economic substance is therefore different from standard securities lending arrangements. The final holder of the bonds has a legal claim on the government, regardless of any repurchase agreement between other bodies, and the government is explicitly committed to cover losses stemming from the use of these assets by the Central Bank in the context of the SLS.

It was also noted that, in essence, the UK government can be seen as strengthening the capital position of the central bank in such a way that it is capable of setting up liquidity operations with the banking system. The arrangement could be seen as being similar to a (temporary) equity injection from government into the Central Bank.

A.4 More generally, even recognising differences between countries, the overall objective of the schemes developed by countries is to inject liquidity in the financial system, using debt instruments. The recording (broad sense) of the transactions made in these frameworks must be similar, particularly regarding the impact on public deficit and public debt.

Furthermore, the scheme is devised in such a way that large amounts of new government securities circulate in the financial markets. This would inevitably affect markets.

A.5 In relation to the CMFB opinion in paragraph 3, the general view is that the second leg of the scheme mostly resembles stock-lending with no cash collateral, and that the normal statistical guidance for such cases should be applied, i.e. the securities should remain on the balance sheet of the lender and the operation should be recorded as an off-balance sheet transaction. The nature of the second leg differs from the first leg, in that for the second leg assets are provided as collateral in return to the provision of government securities and the Central Bank does not lend its own securities.