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The 2008 SNA and the financial crisis

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A. Introduction

1 This note is not intended to introduce major innovations in the SNA. It is simply that, given the excitement about the financial crisis over the last few weeks, it seems desirable to ensure that there is adequate guidance in the SNA to show how each initiative by government or by a central bank in such circumstances would be recorded in the accounts. In a couple of cases, minor refinements of the text may be useful to ensure clarity on what is the appropriate form of recording.

2 The note considers first the units and the types of financial instruments involved to check that our existing classifications are adequate. This is followed by a list of actions, identification of the proposed recording and check with the text to see this is adequately covered.

B. Units

3 For the most part, the units involved already exist and are classified as normal. Some, that were not previously controlled by government may become so. These cases are discussed under nationalisation below.

4 It is possible that government may set up a special institution to handle particular types of financial instruments. If the new unit assumes the risk associated with those instruments, it should be classified as a publicly controlled financial institution. If the risk remains with government, the unit is allocated to the general government sector even though it may constitute a separate institutional unit. For further elaboration, see paragraph 4.67.

C. Instruments

5 There are no new instruments involved but it may be useful to check that those that have featured in the press recently, at least, get a name check in chapter 11 with an indication of how they are treated in the SNA. Collateralised mortgage obligations, (CMOs), and collateralised debt obligations (CDOs) are both forms of asset-backed securities. Credit default swaps (CDSs) are a form of derivative. Note, however, that not all financial instruments described as swaps are derivatives. Gold swaps are treated as loans, as described in paragraph 11.77.

6 The case of short selling of securities is described in BPM paragraph 7.28 where it is explained that in such a case a negative asset is recorded for the unit that sells the security before acquiring it. This should be added to the SNA with a cross-reference to BPM6.
D. **Central bank actions**

1. **Central bank increases money supply**

   The central bank regularly provides the means by which commercial banks to increase the money supply, crisis or no crisis. The only unusual aspect during a financial crisis may be the timing and the size of the increase. No change in recording is involved.

2. **Central bank buys commercial paper**

   Commercial paper is a form of short-term security used as a form of raising cash. It is issued by a financial institution or a large non-financial institution and constitutes a promise to pay a given sum at a specified date in the near future (from 2 to 270 days). The only security given is the reputation of the enterprise issuing it. It is offered at a discount (the discount is recorded in the SNA as interest) but because the risk is low, the return is low also. It is unusual for the central bank to buy commercial paper from non-financial institutions but may do so in exceptional circumstances. Acquisition of commercial paper is recorded as a transaction in securities.

E. **Actions by government**

1. **Government guarantees**

   It is normal for government to offer guarantees in certain circumstances, as discussed in chapter 17. In a financial crisis some extensions to the range of assets guaranteed and the type of guarantee offered may be extended.

   If government offers a guarantee on the sort of conditions that satisfy the criterion of a derivative, such as a credit default swap, it is treated normally as described in paragraphs 17.201 and 22.124.

   Government may offer a one-off loan guarantee to a financial unit in distress. As described in paragraph 17.203, in such circumstance, it may be appropriate to record the guarantee as being called when it is offered.

   Government may extend that range of instruments for which it will provide standardised guarantees in return for a fee. Paragraphs 17.213 and 17.214 discuss the way in which standardised loan guarantees by government are recorded in the accounts.

   Recently, some governments have introduced similar standardised guarantee schemes, in exchange for economically significant fees, for other financial instruments. As one example, in the US such guarantees, provided against payment, have been offered on money market mutual funds; in some cases deposit insurance may also be offered against payment of a fee. Should the discussion in paragraphs 17.213 and 17.214 be amended to cover this extension of cover? If so a corresponding change would need to be made to paragraph 22.123.

2. **Government buys “toxic” assets**

   In order to inject some liquidity into the market, the government may offer to purchase assets whose market has dried up, so-called “troubled” or “toxic” assets. They may be bought by a government unit directly but may be bought by an SPE set up for the purpose. If the SPE is controlled by government, and if the risk associated with the assets acquired by the unit remain with government, it is treated as falling within the general government sector (unless the SPE is non-resident). If the SPE retains the associated risk, then it is treated as a publicly controlled financial institution. The motivation for acquiring the toxic assets is not only to restore liquidity to the market but in the hope that by doing so, government then assumes the risk that the market for the assets will recover when the crisis is past and that it may be able to recover some or all of the cost of acquiring the assets or even recover more than the cost.
The acquisition of the assets is recorded as a financial transaction in the appropriate asset category. Paragraphs 22.129 to 22.131 describe the appropriate recording in such circumstances, including when it is appropriate to record a capital transfer as payable to the unit selling the assets. This text is a special case of the general case described in paragraphs 3.128 to 3.130.

While the principle is clear, in practice it may be very difficult to establish what the fair value of an asset is in situations of financial distress and so the difference between this value and the price actually paid is correspondingly difficult to establish. One way of determining which assets are bought by government and what price is paid may be by means of a “reverse auction” where government chooses to buy those assets offered at the lowest price. However, there may still be a strong presumption that the price paid for the assets is higher than a fair value. If such a value can be estimated (for example by estimating expected future revenue) then the difference between the fair value and the amount paid may be treated as a capital transfer from government to the unit selling the asset to government. It is not possible to determine a fair value, that the transaction has to be recorded at the value actually agreed between the parties.

3. **Government nationalizes a bank**

In principle, nationalising a bank is no different from nationalising a non-financial corporation. Paragraph 22.148 describes two means by which nationalisation may occur. In effect, though, the text in paragraphs 22.128 to 22.134 under the heading of bailouts, describes a third means by which nationalisation is achieved. In these cases, the assets and liabilities of the bank (or other unit being bailed out) are transferred to the government and are recorded in the other change in the volume of assets account. At the moment of transfer, the (negative) net worth of the bank does not change but customers are reassured that the government will not default on the liabilities of the bank it has acquired. Any subsequent actions, such as the injection of funds into the bank, are recorded in the normal way. *It is suggested that moving the section on bailouts to immediately follow nationalisation would be advantageous with a phrase that this in effect is another way in which nationalisation is achieved.*

4. **Government injects funds into a firm by means of preference shares**

Government may inject funds into a bank without establishing control over it. Often this will be done by means of acquiring preference (or preferred) shares. In some ways, preference shares function rather like loans without a maturity date. They are for a fixed amount and carry a return agreed at the time they are issued, often a fixed rate of return. If the fixed return is not paid in full, any short-fall increases the value of the preference shares. This return is not solely dependent on the profitability of the bank as is the case for ordinary share.

Preferred shares may be participatory or non-participatory. A participatory preferred share is one that not only provides an agreed income but also provides a claim on the residual value of the company in the case where it is wound up in the same way as ordinary shares. A non-participatory preferred share provides the agreed income only. Non-participatory preference shares are treated as debt securities, as explained in paragraph 11.66; participatory preference shares are treated as equity (see paragraph 11.84).

5. **The impact of the actions above on government revenue and debt**

In the case of the purchase of assets and the injection of capital into an enterprise, if the necessary funds are realised by disposing of existing assets, there is no impact on government debt; only the composition of assets changes. However, if in order to raise funds to meet these needs, government issues new securities, for example, then government debt increases accordingly.

In both cases, there may be future revenue arising from the assets acquired. This is also the case for preference shares.

In the case of standardised government guarantees issued for a fee, there will be revenue to the government. The impact of one-off guarantee will depend on the conditions attached to it.
F. Impacts on commercial banks

1. Inter–bank lending

Paragraph 6.166 contains the following two sentences:

The rate prevailing for inter-bank borrowing and lending may be a suitable choice as a reference rate

For banks within the same economy, there is often little if any service provided in association with banks lending to and borrowing from other banks.

While these statements are not categorical, it may be advantageous to point out that the usual assumptions are unlikely to apply in a financial crisis and that banks may indicate their unwillingness to lend to one another by charging rates significantly in excess of a reference rate. It is neither desirable nor intended to go further than such a cautionary note but ensure this is covered as part of the research agenda item concerning FISIM.

2. Impaired assets

One innovation in the 2008 SNA was to introduce memorandum items for non-performing loans in respect of both stocks and flows. It is possible that such memorandum items might be considered for other instruments, such as deposits and accounts receivable. Should similar advice on memorandum items be given for these other types of assets that may be impaired?

Under pressure caused by the present crisis, the IASB has recently varied its advice on which assets should be “marked to market” and allows fair value reporting in some circumstances. It should be noted as part of the research agenda that monitoring the developments of IASB and other international and national accounting standards setters is important for the SNA.