Box 3

THE IMPORTANCE OF ACCOUNTING STANDARDS FOR INTERPRETING MFI LOAN STATISTICS

The continued strong growth of MFI loans to the non-financial private sector[1] during the recent period of financial turmoil has raised the question of whether such strong borrowing might partly reflect an inability on the part of banks to "derecognise" loans (i.e. to remove them from their balance sheets) in the context of true-sale securitisation programmes.[2] It has even been suggested that strong lending to the non-financial private sector may result from forced re-intermediation of previously securitised loans (i.e. banks having to take loans back onto their own balance sheets, as the financing of securitisation vehicles becomes unsustainable in the ongoing turmoil). This box discusses the implications of the International Financial Reporting Standards (IFRS), which have been applied to the accounting underlying the construction of MFI balance sheet statistics in a number of euro area countries since 2005, for these questions. An important regulation within the IFRS is International Accounting Standard No 39 (IAS39) on the recognition and measurement of financial instruments.

The importance of accounting standards for the re-intermediation of MFI loans

The accounting treatment of true-sale securitisations of MFI loans under IAS39 may differ from that under national accounting standards. National accounting standards often allow a full or at least partial removal of such loans from the MFI balance sheet. Applying such rules would hence imply that true-sale securitisation would lead to a reduction of the outstanding amount of loans on the MFI balance sheets.

1 The non-financial private sector comprises the household sector and non-financial corporation sector, but excludes the other financial institution sector and the insurance corporation and pension fund sectors.
2 For an explanation of true-sale securitisation, see the article entitled "Securitisation in the euro area" in the February 2008 issue of the Monthly Bulletin.

IAS39, by contrast, only allows full derecognition of true-sale securitised loans when the securitisation transaction meets certain strict criteria, such as a substantial transfer of risks and rewards, or the surrender of the MFI's control over the securitised assets. In most securitisation transactions in the euro area (due, in part, to requirements imposed by bank regulators), some of the risk remains on the balance sheet of MFIs. For example, MFIs may offer a credit enhancement facility or keep the first part of the loss on the securitised loans (e.g. by holding some of the so-called equity tranche). Thus, under IAS39, the true-sale securitisation of assets, even to a bankruptcy-remote vehicle, may not be sufficient to achieve a substantial transfer of economic risks and, thereby, the removal of the loans from the MFI's balance sheet. Furthermore, while IAS39 theoretically allows a partial derecognition of loans after their transfer to bankruptcy-remote special purpose entities, it seems that, in practice, only few existing securitisations have qualified for such an approach.[3]

While following EU Regulation No 1606/2002 the IFRS have to be applied to consolidated bank accounts (across geographical areas and different entities of the group/conglomerate), their application to the unconsolidated national MFI accounts, which are the basis for the compilation of the Eurosystem monetary statistics (BSI statistics), differs across euro area countries.

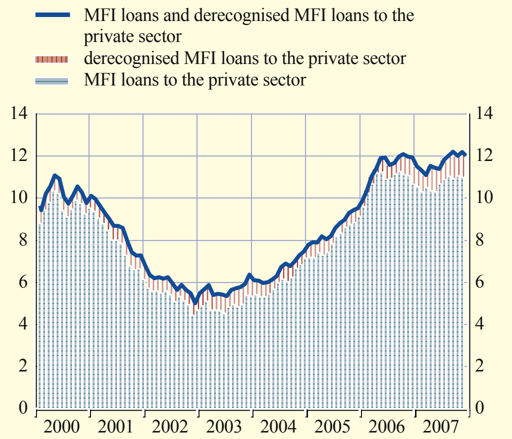
Measuring the impact of derecognised loans on the MFI balance sheet total

In a number of Member States, in particular those where true-sale securitisation had become increasingly popular over recent years, the IFRS and IAS39 are also applied to the unconsolidated national MFI accounts. The impact of true-sale securitisations on the outstanding amount of MFI loans on the euro area aggregate has thus remained relatively limited. This can be seen from the

3 The derecognition of loans in countries that apply IFRS is sometimes restricted further by regulatory rules that require, for example, the first part of a loss on the securitised loan to be kept on the MFI balance sheet. See also Fitch, "Bank Securitisation: IFRS Versus Basel II – Risk Transfer Revealed", Special Report, 2006.

Chart A MFI loan growth and the impact of loan derecognition

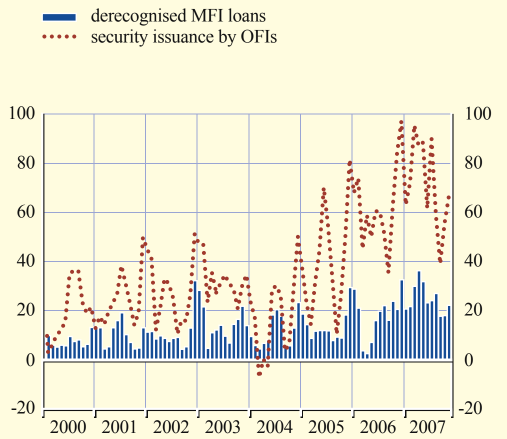
(annual growth rate in percentages; contributions in percentage points)



Source: ECB, ECB estimates.

Chart B MFI loan derecognition and asset-backed security issuance by OFIs resident in the euro area

(three-month moving sum of flows; EUR billions)



Source: ECB.
Notes: Security issuance may also include synthetic securitisations that do not contribute to a derecognition of MFI loans. The issuance data omit issuance by non-resident OFIs.

relatively small difference between the annual growth rate of MFI loans and the annual growth rate of MFI loans taking into account derecognised loans (see Chart A). It is also illustrated by the rather limited amount of derecognised MFI loans relative to the issuance volume of asset-backed securities by non-monetary financial intermediaries other than insurance corporations and pension funds in the euro area in recent years (see Chart B).

What is important to note is that the flow of derecognised MFI loans in the period of financial market turmoil has remained positive. On a net basis, re-intermediation cannot, therefore, play a major role in explaining the currently strong growth of loans to the non-financial private sector.

Conclusions

While the "originate and distribute" model of banking has gained considerable importance in recent years in some euro area countries, this has not led to a large-scale derecognition of loans as a result of the application of the IFRS and IAS39 in a number of euro area countries. At the same time, the continued positive flow of derecognised loans supports the argument that the development of MFI loan growth to households and non-financial corporations has remained relatively undistorted by re-intermediation effects.