

Box 10

**USING DATA ON MFIS' STATISTICAL REVALUATIONS TO GAUGE INFORMATION ON CHANGES
IN BANKS' TRADING-BOOK VALUATIONS**

Valuation losses in the trading books constituted the first wave of losses suffered by euro area LCBGs in the current crisis, triggered by the collapse of the US sub-prime market. More recently, estimating potential losses from banks' government bond portfolios formed an important part of the EU-wide stress-testing exercise carried out in July 2010. The important role played by trading-book holdings for the profit and loss accounts of many LCBGs has intensified the need

for monitoring, stress testing and possibly also forecasting the valuations of banks' trading books for financial stability purposes. An important impediment to this work is the limited availability of data from public sources which consist mainly of quarterly or annual observations from banks' published financial reports. This box focuses on the statistical revaluations data collected under Regulation (EC) No 25/2009 of the ECB of 19 December 2008 concerning the balance sheet of the monetary financial institutions sector (recast) (ECB/2008/32)¹ and discusses its usefulness in providing information for the analysis of changes in trading and banking-book valuations at the aggregate banking sector level.²

Official statistics on transactions involving MFI holdings of securities are calculated regularly by adjusting changes in the outstanding amounts of securities for the impact of variations in market values, as well as changes in exchange rates and instrument classifications.³ While, in principle, euro area MFIs report holdings of securities on a marked-to-market basis, or using a close equivalent to market value (fair value), it is accepted that MFIs follow national accounting practices mainly in recognition of the tight reporting deadlines. For example, according to these practices, Member States may allow banks to value their trading portfolio at purchase price, at market price or at the lower of the two. The extent of MFI revaluations typically depends on the asset class, the classification of the asset by the bank (in the trading book or in the banking book, including its sub-categories – for instance, as available-for-sale or held-to-maturity), internal valuation strategies (in case assets are valued on a marked-to-model basis) and market conditions.⁴

The gradual introduction of the IASs/IFRSs in the European Union and their use instead of national practices for the solo accounts have contributed to the harmonisation of the valuation rules across Member States. In particular, under IAS 39, banks should value their holdings of securities in the trading book at fair value, thus bringing the revaluation adjustments reported under Regulation ECB/2008/32 for these securities closer to the concept of portfolio gains or losses. Similarly, held-to-maturity debt securities and participations are measured at amortised cost and cost respectively, so that they have no impact on the amounts of revaluations, or on the profit and loss account. Possible misalignments between the revaluation statistics and gains/losses may arise from those securities that are classified in the available-for-sale portfolio, for which IAS 39 prescribes to use the fair value: changes in prices will be recorded as revaluations, but they will be mirrored by capital and reserves, thus without any impact on the profit and loss account.

1 It should be recalled that MFI balance sheet items (BSI) statistics and supervisory data essentially differ in terms of the reporting population and the scope of geographical, sectoral and group consolidation. In particular, under the BSI framework, the reporting population consists of the MFIs resident in each Member State ("host country principle") and no consolidation is performed for non-bank subsidiaries or across national boundaries. For instance, the gains/losses of non-euro area subsidiaries of euro area MFIs are not covered in BSI statistics. For more details on methodological linkages and differences between BSI statistics and supervisory data, see CEBS/ECB, "MFI balance sheet and interest rate statistics and CEBS' guidelines on FINREP and COREP", Frankfurt, February 2010 (available at <http://www.c-eps.org>).

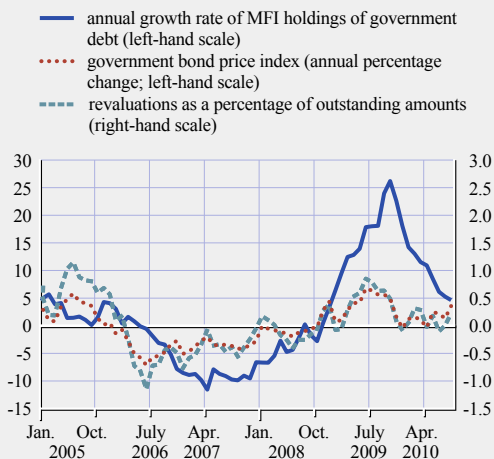
2 Euro area MFIs' holdings of securities issued by domestic residents accounted for, on average, about 20% of their total assets in the first half of 2010, while holdings of securities issued by non-euro area residents constituted another 5% of their total assets. In BSI statistics, securities holdings are not broken down according to the accounting classification, i.e. as set out in the International Financial Reporting Standards (IFRSs): trading book, designated at fair value through profit and loss, available-for-sale, held-to-maturity, loans and receivables account and participations.

3 Hence revaluation data are collected for statistical purposes, rather than to obtain information on holding gains/losses as such, and their interpretation much depends on the accounting rules that are followed by MFIs when reporting for BSI purposes. For a given change in market values, the reported revaluations will be higher when the share of the securities portfolio reported at current market value is higher.

4 Data on revaluations of euro area MFIs' holdings of securities (broken down by instrument, sector of the issuer and currency of denomination) are published at monthly frequency in Table 2.7.3 of the "Euro area statistics" section of the ECB's *Monthly Bulletin*.

Chart A Euro area MFI holdings of debt securities issued by euro area general government, revaluations and the euro area government bond price index

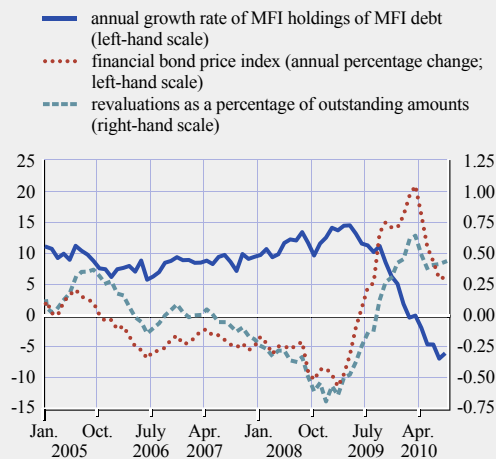
(Jan. 2005 – Aug. 2010; percentages, revaluations expressed as 12-month moving sums)



Sources: Bank of America Merrill Lynch, ECB and ECB calculations.

Chart B Euro area MFI holdings of debt securities issued by euro area MFIs, revaluations and the euro area financial bond price index

(Jan. 2005 – Aug. 2010; percentages, revaluations expressed as 12-month moving sums)



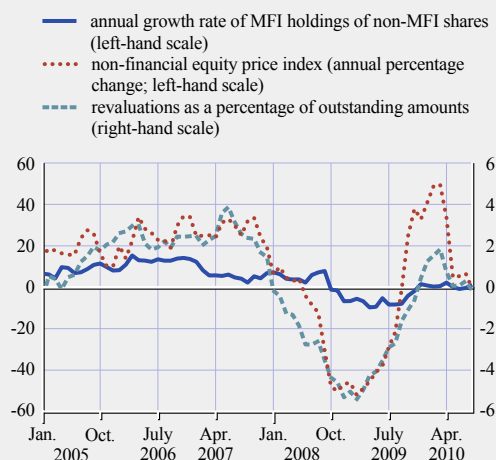
Sources: Bank of America Merrill Lynch, ECB and ECB calculations.

As regards holdings of debt securities, euro area government bonds held by MFIs suffered negative revaluations between early 2006 and the middle of 2008. As from the second half of 2009, however, they were only occasionally subject to negative revaluations that reflected the fluctuation in prices as the problems in public finances in several euro area countries gradually intensified. This coincided with a stabilisation and subsequent moderate slowdown of the annual growth rate of MFIs' government bond holdings (see Chart A). As from 2009, by contrast, there was a sharp decline in MFI holdings of debt securities issued by other banks, although MFI bond prices increased in the same period, coupled with positive revaluations (see Chart B).⁵

Regarding holdings of shares issued by the euro area private sector, euro area MFIs suffered from large negative revaluations after the default of Lehman Brothers in September 2008. These losses coincided with a large-scale shedding by banks of this type of assets (see Chart C). However, after mid-2009, the revaluation losses on the shares came to an end.

Chart C Euro area MFI holdings of shares issued by the euro area private sector, revaluations and the euro area non-financial equity price index

(Jan. 2005 – Aug. 2010; percentages, revaluations expressed as 12-month moving sums)



Sources: Bank of America Merrill Lynch, ECB and ECB calculations.

⁵ Holdings of debt securities issued by euro area general government and MFIs accounted for, on average, around 11% of the total assets of euro area MFIs in the first half of 2010; in some large euro area countries, however, holdings of these two securities classes came to 14% of MFIs' total assets.

Overall, despite the caveats explained in this box, the MFI revaluation data therefore provide useful information about marking-to-market changes in banks' balance sheets which can act as important triggers for changes in banks' investment decisions. These data, which are available at monthly frequency, provide more timely indications than banks' quarterly reports on revaluations of their securities holdings, which form a substantial part of LCBGs' balance sheets. In the future, subject to further efforts being undertaken to reconcile revaluation data with banks' gains/losses, these series would thus provide early-warning indicators on such losses and allow the stress testing of trading-book valuations.