Treatment of Special Bank Interventions in Irish Government Statistics

Mary Cussen and Mick Lucey[1]

Abstract

The financial crisis has led Governments to intervene in a number of ways to support and stabilise the banking system. The recording of these interventions can be quite complex in statistical terms, as Government accounting rules set down for the purposes of the Stability and Growth Pact need to be applied consistently and transparently across EU Member States. Our paper firstly focuses on Government interventions in the case of Ireland. Since 2008 the Irish Government has had to intervene significantly in the banking sector and this has had a substantial impact on Irish debt and deficit. In addition, the sovereign debt crisis has increased analysts' requirements for detailed information on the impact of these interventions in the banking sector on Government debt and deficit and has increased the need for higher frequency government statistics. Our paper examines the extent to which current Government statistical reporting meets these requirements.

1 The authors are a Senior Economist in the Central Bank of Ireland and a Senior Statistician in the Central Statistics Office. The views expressed are solely the views of the authors and do not necessarily reflect the view of the Central Bank of Ireland or of the Central Statistics Office. The authors would like to acknowledge the helpful comments of Aidan Punch, Joe McNeill, Ciaran Judge and Rod O'Mahony. This paper is an updated version of a paper that was presented at the ISI 2011 Congress in Dublin on 23rd August 2011.

1 Introduction

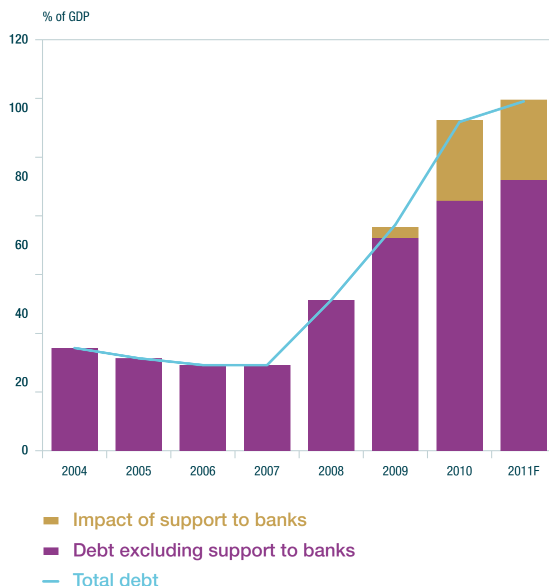
The financial crisis has led many governments to intervene to support and stabilise their banking systems. These support measures have been made in a variety of ways and their recording in statistical terms can be difficult. This creates problems, especially for the Government accounts compiled by Member States of the euro area and the wider EU. These accounts are used to assess if countries comply with the terms of the Stability and Growth Pact, so the accounting rules used need to be transparent and unambiguous and must be applied consistently by all reporting countries.

Since September 2008, the Irish Government has intervened to support the banking sector in a myriad of ways. These interventions, coupled with the economic recession which began in Q2 2008, led Ireland to record in 2010 the highest ever reported deficit in the European Union. Section 2 of the paper outlines the impact of these interventions on Irish debt and deficit and presents an overview of the banking support measures introduced by the Government. Section 3 shows the impact of recapitalisations on the levels of General Government deficit and debt. Section 4 describes how some other interventions were treated in Government accounts and discusses an important outstanding accounting issue relating to the classification of publicly-owned 'bad banks'. The sovereign debt crisis has increased analysts' requirements for detailed information on the impact of these interventions in the banking sector on Government debt and deficit and has also increased the need for higher frequency Government statistical information. Section 5 of the paper examines the extent to which current Government statistical reporting meets these requirements.

2 The Reaction of the Irish Government to the Financial Crisis

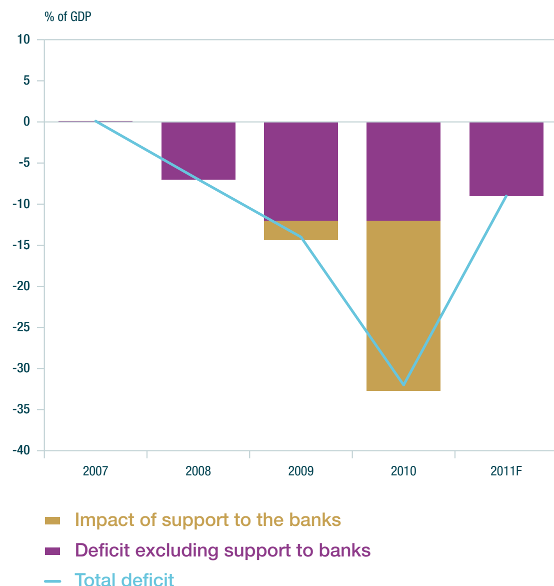
The deterioration of Irish Government finances as a result of the financial crisis and economic recession is evident from Charts 1 and 2. Ireland's gross debt is forecasted to rise to 102 per cent of GDP[2] in 2011, assuming there are no further debt-increasing capital injections

Chart 1: Irish Government Debt



Sources: EDP and internal calculations.

Chart 2: Irish Government Surplus/Deficit



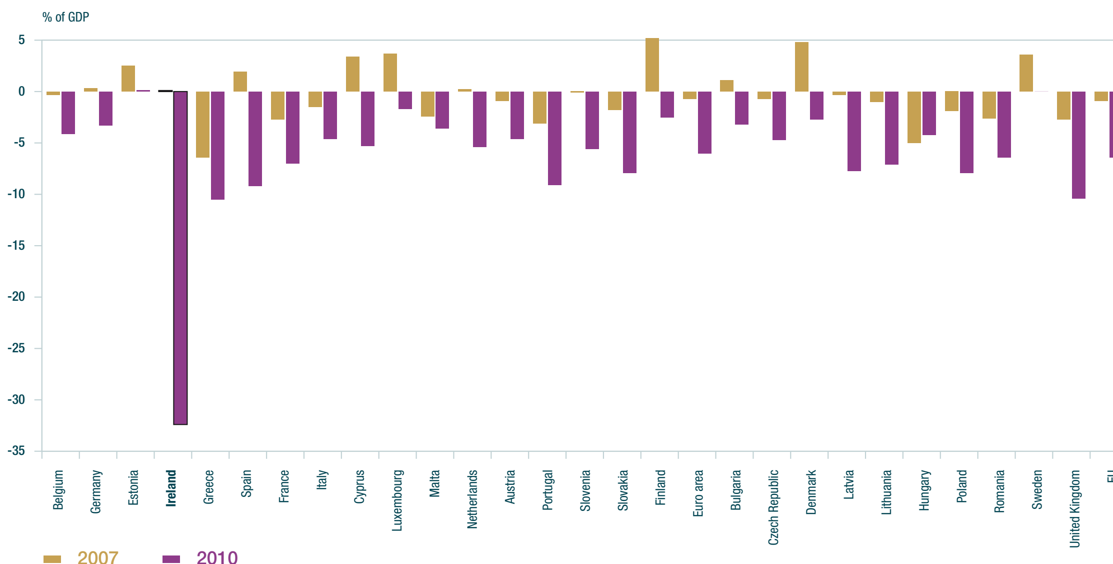
Sources: EDP and internal calculations.

2 The 2011 forecast of Debt to GDP is based on the latest Excessive Deficit Procedure (EDP) tables of March 2011. The Department of Finance will compile an updated set of EDP tables for September 2011. EDP defines debt as gross debt, as opposed to net debt.

Chart 3: Government Debt as a Percentage of GDP for EU Member States

Source: Eurostat.

Chart 4: Government Surplus/Deficit as a Percentage of GDP for EU Member States



Source: Eurostat.

during the year. This marks a substantial increase from the pre-crisis, pre-recession debt levels of 25 per cent of GDP in 2007. Government support to the banking sector increased debt by 2.4 per cent of GDP and 20 per cent of GDP during 2009 and 2010 respectively, as shown in Chart 1. These sharp increases in debt were driven by very substantial fiscal deficits from 2008 onwards. In 2010, the Irish deficit reached 32 per cent of GDP, of which 20 per cent of GDP was due to State support to the banking sector.

The financial crisis and general economic downturn have had an adverse effect on the Government finances for nearly all European Union (EU) countries. The debt and deficit of all EU countries for the pre-crisis year 2007, and also 2010 are presented in Charts 3 and 4 respectively. The charts show that most countries have experienced an increase in debt and deficit levels since 2007. The figures highlight however, the severity of the crisis on Irish Government finances in contrast to other EU countries. In 2007, 19 EU countries had

Table 1: Timeline of Irish Government interventions in the banking sector

Date	Event	Amount	% of GDP[4]
2008	Guarantee of the banking sector	€352 bn guaranteed	191.7
2009	Nationalisation of Anglo Irish Bank	nil	nil
2009	Capital injections into BoI (Acquisition of preference shares for cash)	€3.5 bn	2.2
2009	Capital injections into AIB (Acquisition of preference shares for cash)	€3.5 bn	2.2
2009	Capital injections into Anglo (Acquisition of equity for cash)	€4 bn	2.5
2010	NAMA established	€28.7 bn guaranteed	18.6
2010	Capital injections into Anglo (Injection of promissory note)	€25.3 bn	16.4
2010	Nationalisation of EBS and INBS	nil	nil
2010	Capital injections into EBS (Acquisition of equity)	€0.875 bn	0.6
2010	Capital injections into INBS (Injection of promissory note)	€5.4 bn	3.5
2010	Restructuring of Anglo and INBS	nil	nil
2010	Capital injections into AIB (Acquisition of equity for cash)	€3.7 bn	2.4
2011	Capital injections to meet PCAR stress test results[5]	€17.6 bn	11.2

Source: Internal calculations.

higher debt levels than Ireland, and Ireland's surplus of 0.1 per cent of GDP was the eleventh highest in the EU. By 2010 however, Ireland had the fourth highest debt-to-GDP ratio in the EU and had a deficit of 32 per cent of GDP, the highest ever recorded in the EU.

The measures taken by the Irish Government to stabilise the banking sector are set out in Table 1. The first intervention measure taken by the Government was to guarantee all of the liabilities of the Irish banks on 30 September 2008, in order to alleviate liquidity pressures experienced by the banks as a result of the international financial crisis. "The initial expectation of officials at the time of the guarantee was that none of the institutions involved was insolvent, and that their problems stemmed mainly from a freezing of short-term liquidity in the wake of the bankruptcy of Lehman Brothers" (Honohan *et al*., 2010). However, it subsequently became clear that the banking sector suffered from other vulnerabilities. Property-related lending as a share of banks' assets had grown from less than 40 per cent before 2002 to over 60 per cent by 2006 (Honohan, 2009). As the recession deepened and property prices continued to rapidly decline, it became evident that the over-exposure of the banking sector to property-related lending was a serious problem. In addition, it had been found that poor lending practices had prevailed during the years preceding the crisis in some banks[3]. Consequently, the Government had to intervene to further support the banking sector between 2009 and 2011. These interventions included the nationalisation of three banks, capital injections into five banks, the establishment of the National Asset Management Agency (NAMA) and the restructuring of Anglo Irish Bank (Anglo) and Irish Nationwide Building Society (INBS). The statistical treatment of the capital injections and the other measures in Government finance statistics are analysed in detail in Sections 3 and 4, respectively.

3 The factors contributing towards the Irish banking crisis have been examined in detail in Honohan *et al.* (2010), Regling and Watson (2010) and Nyberg (2011).

4 The % of GDP calculations are calculated by reference to the GDP of each year. These are: €179.99bn for 2008, €160.60bn for 2009 and €155.99 bn for 2010.

5 The Prudential Capital Assessment Review (PCAR) assessed how much additional capital the banks would require under adverse scenarios. PCAR is discussed further in Section 3.

3 The Impact of Recapitalisations on Debt and Deficit

Since 2009, the Irish authorities have provided the banking sector with capital injections amounting to €64 billion, equivalent to 41 per cent of Irish GDP. These have taken a number of different forms including: preference shares, ordinary shares and promissory notes. This section discusses the treatment of these capital injections in the Irish Government finances.

Recapitalisations have a debt-increasing impact if they result in additional borrowing. They have a deficit-increasing impact if the capital injections are considered capital transfers because they cannot yield a sufficient rate of return in line with EU State Aid rules or if the price paid for the shares exceeds the market price. In 2009, the State provided two Irish banks, Allied Irish Bank and Bank of Ireland, with capital injections of €3.5 billion each. The injections took the form of 8 per cent preference shares. As the shares offered a guaranteed rate of return in line with EU State Aid rules, they had no deficit impact. The State funded €5.8 billion of the capital injection through the National Pension Reserve Fund (NPRF)[6]. Consequently, the debt impact of the recapitalisations was €1.2 billion. During 2009, the State also provided Anglo with capital of €4 billion. As the Government had to borrow to fund this recapitalisation, it had a debt increasing impact of €4 billion. Initially, the capital injection was treated in the accounts as a financial transaction. It was subsequently discovered that Anglo would not be able to repay the capital injection and the amount was reclassified in the 2009 accounts as a deficit-increasing capital transfer.

Capital injections into the Irish banks in 2010 totalled €35.275 billion, 23 per cent of Irish GDP. The largest capital injections were provided to Anglo and INBS. Since 2009, these banks have reported massive loan write-downs and operating losses. Both banks had primarily engaged in property-related lending in the years preceding the crisis and it has since been discovered that these banks had inadequate risk procedures (see Nyberg, 2011). During 2010, capital injections to Anglo and INBS totalled €25.3 billion and €5.4 billion, respectively. Given the scale of losses reported by these banks, the capital injections will be unrecoverable by the State and consequently were treated as deficit-increasing capital transfers in the accounts. The capital injections were funded by promissory notes issued by the State to Anglo and INBS in lieu of cash. These notes will be redeemed over a period of several years with the State committed to making annual repayments of at least 10 per cent of their initial capital value. This phasing of payments means the State does not require upfront funding for the capital injection. However, the promissory notes do impact the debt from the date they were issued. In effect, the transactions can be viewed as if the capital injections were made in cash which was then lent back to the Government in return for the promissory notes. The capital injections to Anglo and INBS, therefore, added 19 per cent to both the debt and deficit for 2010.

A feature of the promissory notes issued to Anglo and INBS is that the contracts provided for an initial grace period of two years during which no interest will be charged on the notes. A higher rate of interest was chargeable for the remainder of the period so that the cumulative amount of interest paid over the period of the promissory notes remained at an average rate sufficient to allow them to be recorded on the institutions' balance sheets at face value, notwithstanding the zero rate of interest charged in the initial two years.

In the ESA based national accounts, interest is usually recorded on a strict accruals basis, but the Manual on Government Deficit and Debt (MGDD) provides an exception for the recording of interest during such grace periods. This means that the General Government Deficit (GGDeficit) and General Government Debt (GGDebt) for Ireland for the years 2011 and 2012 will not be affected by interest on these notes. In subsequent years the full amounts of interest chargeable will be recorded on an accruals basis and both the deficit and debt will be worsened by these amounts.

6 The National Pension Reserve Fund is a State fund established to meet the cost of Ireland's social welfare and public service pensions from 2025 onwards.

Table 2: The impact of capital injections on debt and deficit, 2009 – 2010

	2009			2010			Total to date		
	Capital Injections	Impact on Debt	Impact on Deficit	Capital Injections	Impact on Debt	Impact on Deficit	Capital Injections	Impact on Debt	Impact on Deficit
Total (€bn)	11	5.2	4	35.275	31.575	30.850	46.275	36.775	34.850
Total % GDP	6.9	5.3	2.5	22.9	20.5	20.0	29.8	25.8	22.5

It appears that this provision in the MGDD was primarily intended for the recording of interest holidays on concessionary loans provided by Governments and the text in the manual is currently being updated to confine the application of the rule in future.

Capital injections amounting to €875 million were also provided during 2010 to EBS, a relatively small Irish building society. These increased the deficit by the full amount, while debt increased by €250 million, as they were partly financed from existing resources. In December 2010, AIB received a further capital injection of €3.7 billion, which was fully funded by the NPRF and therefore did not impact the Irish debt. Furthermore, it was treated in the accounts as an investment and therefore does not directly impact the deficit. The total capital injections provided by the State to the banking sector since 2009, are summarised above in Table 2. The table shows that since 2009, capital injections have increased the Irish debt and deficit by 25.8 per cent of GDP and 22.5 per cent of GDP, respectively.

In order to fully ascertain what future capital requirements the Irish banks may need, the Central Bank performed in-depth stress tests in late 2010/early 2011. The tests were extremely detailed and assessed what the maximum amount of capital required by the banks could be under very adverse economic conditions. As a result of the tests, the Central Bank required banks to increase their capital levels. The results showed that the banks could require €24 billion. Bank of Ireland's capital requirements were met in part by private sector investment in the bank. During July 2011, the State provided €17.6 billion to the banks to meet the remainder of capital requirements outlined in the stress tests. A significant proportion of the financing provided by the State was met using funds from the NPRF. The impact of the capital injections on Government debt will depend on the amount of new financing which was required. The impact on the deficit will depend on whether the State will ever receive a return on the injections.

4 The impact of other measures on debt and deficit

4.1 Guarantee schemes

As shown earlier in Table 1, the initial banking support measure provided by the Irish Government was the introduction of a guarantee scheme covering the liabilities of credit institutions which were not already covered under the standard retail deposit guarantee scheme operated by the Central Bank of Ireland. The new scheme called the Credit Institutions Financial Support Scheme (CIFS) was introduced on 30 September 2008, for a period of two years. It was a blanket type guarantee scheme and covered the existing deposits, senior debt, covered bonds and dated subordinated debt liabilities of six Irish credit institutions. Liabilities covered by the scheme initially amounted to €352 billion, which was equivalent to almost three times the value of Irish GDP. A further, more limited guarantee scheme, the Eligible Liabilities Guarantee (ELG) Scheme, was introduced in December 2009. This covered new deposits and eligible debt securities up to a maximum maturity of five years which were issued after the banks joined the new scheme.

The CIFS scheme expired in September 2010. The need for the ELG scheme is reviewed every six months and most recently it has been extended to the end of 2011. It operates alongside the standard Deposit Guarantee Scheme run by the Central Bank of Ireland,

Table 3: Contingent liabilities related to the financial crisis outstanding at end-March 2011

Member State	Value (€ billion)	% of GDP
Ireland	193	125
Greece	58	25
United Kingdom	417	25
Cyprus	3	17
Belgium	56	16
Denmark	26	11
Austria	22	8
Netherlands	40	7
Slovenia	2	6
Sweden	20	6
Spain	60	6
France	91	5
Luxembourg	1	3
Portugal	5	3
Germany	71	3
Euro area (EA17)	602	7
EU27	1,065	9

Source: Eurostat.

which covers 100 per cent of retail deposits with all credit institutions authorised in Ireland (including credit unions) up to a maximum of €100,000 per qualifying depositor per institution. This latter scheme has no end-date.

All the above schemes relate to Government guarantees on the liabilities of the banking sector. The Irish Government has generally not provided guarantees on bank assets. However, as part of the Emergency Liquidity Assistance (ELA) facility provided by the Central Bank of Ireland, the Government has provided guarantees to the Central Bank for certain bank assets provided as collateral by the banking sector.

Guarantees in National Accounts are treated as contingent liabilities and are not recorded on balance sheets unless they are absolutely certain to be called upon. In Ireland's case all the repayment obligations under the above schemes have been met in full, so none of the guarantees given to the banks have been activated to date. This means the guarantee schemes have had no direct impact on the levels of Irish gross Government debt. The banks covered by the CIFS and ELG schemes pay guarantee fees, which in the National Accounts are treated as service incomes and improve the GGDeficit. However, these fees are intended to compensate the Government for the additional borrowing costs it incurred as a consequence of the extensive guarantees provided to the banks. To the extent that the guarantee fees simply compensate the Government for the extra interest margin it pays on its borrowings, the net impact on the GGDeficit was envisaged to be neutral.

While guarantees are contingent liabilities and are not recorded in the Government accounts, information on the levels of guarantees outstanding is important for assessing the sustainability of the public finances. As part of its twice yearly Excessive Deficit Procedure (EDP) reporting requirements, Eurostat asks Member States to quantify the amount of guarantees outstanding in respect of the financial crisis. These data are published on the Eurostat website and the most recent data are summarised in the table above.

4.2 National Asset Management Agency (NAMA)

In early 2009, the Irish Government decided to introduce measures to address concerns about asset quality in the Irish banking system. The principal uncertainties related to the quality of the land and development loans held by the

credit institutions. In a supplementary budget in April 2009, the Government announced the establishment of the National Asset Management Agency (NAMA). The Agency was to acquire loan assets from the banks and to manage and dispose of these assets over an extended period of up to ten years. The prices paid would be based on assessed long-term market values and the purchases would be funded by NAMA issuing debt securities, 95 per cent of which were guaranteed by the Irish Government.

When formally establishing NAMA, the Irish authorities were cognisant of the accounting guidelines issued by Eurostat on 15 April 2009, on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis. These guidelines, which were clarified in a further release in September 2009, contained a section dealing with the classification of new entities established during the financial crisis to support the stability of the banking system. This issue had arisen specifically in the case of the French financial corporation, Société de Financement de l'Économie Française (SFEF). This company had been established in October 2008 to provide liquidity funding to French banks. SFEF was majority owned by the banks but the bonds it issued to raise funds were guaranteed by the French Government. As a consequence of its guarantee, the French State maintained an overall right of veto on the operations of SFEF. The Eurostat guidelines concluded that, under very restrictive conditions, this type of company could be classified outside of Government, on the basis of its majority private ownership, even though its liabilities were guaranteed by Government which also exercised ultimate control through its veto right.

NAMA, which is classified within General Government, was formally established in December 2009 and used a SFEF-type structure to acquire the problematic loan assets from the banks. It established a special purpose company called National Asset Management Agency Investment Limited (NAMAIL), 51 per cent owned by private investors and 49 per cent owned by NAMA, to acquire the assets. In order to facilitate risk-sharing with the banking sector, only 95 per cent of the securities provided by NAMAIL in payment for the assets acquired from the banks were guaranteed by the State. The remaining 5 per cent was subordinated debt repayable only if NAMAIL made a profit. As a condition of the State guarantee, NAMA maintained a veto over all activities of NAMAIL that affected the interests of NAMA or of the Irish State.

After an in-depth examination of the structures, the Central Statistics Office, with Eurostat's agreement, accepted that, based on the published guidelines, the special purpose company NAMAIL could be classified in the Financial Corporations Sector (S.12), outside of General Government. In general, defeasance vehicles created by Government to deal with impaired assets should be classified in the General Government Sector (S.13) so in this case the classification of NAMAIL in the Financial Corporations Sector (S.12) was on the basis of a set of very restrictive conditions. These were that the company was majority privately owned, was of a temporary duration, was created solely to deal with the financial crisis and was not expected to incur losses. This final condition was especially important insofar as the asset values booked in the typical defeasance vehicle in other countries have often overstated recoverable values so that on disposal, the assets have generated significant losses. In the case of NAMAIL, the loan assets were being acquired at already written-down prices and additional safeguards were put in place so that in the event of the company incurring future losses, these would be paid for by the banks.

In line with its mandate, NAMAIL imposed very significant haircuts or discounts on the loan portfolios it acquired from the banks. By the end of 2010, NAMAIL had acquired loan assets of a nominal value of over €71 billion from five[7] participating institutions – Allied Irish Bank (AIB), Bank of Ireland (BoI), Anglo Irish Bank (Anglo), Irish Nationwide Building Society (INBS) and Educational Building Society (EBS).

7 Irish Life and Permanent (IL&P) was not included in the NAMA asset acquisition scheme.

Table 4: Details of loans acquired by NAMAIL up to end-December 2010

	AIB	BoI	Anglo	INBS	EBS	Total
Amount paid by NAMAIL (€ bn)	8.4	5.4	12.9	3.0	0.3	30.2
Discount on loans (%)	54%	42%	62%	64%	60%	58%
Implied nominal value of loans (€ bn)	18	9	34	9	1	71

Source: NAMA report & internal calculations.

These loans included both performing and non-performing loans of the banks' debtors that had significant exposure to the property sector. The amounts paid for individual loans ranged from 0 to 100 per cent of the book value. By end-2010, NAMAIL had in total paid €30.2 billion for loans with a nominal value of €71.4 billion. This represented an average discount of 58 per cent. As shown in the following table, the aggregate haircut or discount applied to the individual banks ranged from 42 per cent to 64 per cent.

By end-March 2011, the nominal value of loans acquired had increased to €72.3 billion for which a consideration of €30.5 billion had been paid. The imposition of such severe haircuts meant that losses on the problematic assets of the banks were immediately crystallised. This in turn created significant capital shortfalls in the banks. The result, as described earlier, was that the Irish Government was then obliged to inject large amounts of capital into the banks in order for them to continue to meet their capital reserve requirements.

Classification of NAMAIL outside of the General Government Sector helped avoid the possibility that Irish GGDeficit levels could be artificially distorted as a result of loan foreclosures. Under the European System of Accounts (ESA), which is the legally binding manual upon which Government accounts are based, the acquisition or disposal of a non-financial asset will have an impact on the Government deficit. Also in the accounts, the foreclosure of collateralised loans are treated as two separate transactions, namely (1) the redemption of the original loan and (2) the acquisition of the underlying collateral (SNA93[8]. Para 12.40).

Most of the problematic loan assets held by NAMAIL are secured on physical assets, such as land and property. In the event of a default by a debtor, NAMAIL forecloses on the loans and acquires ownership of the assets provided as collateral. To give a simple example[9], if NAMAIL was included in the Government sector and foreclosed on a loan with a nominal value of €500 million, for which collateral worth €400 million had been provided, the statistical treatment in Government accounts would be as follows. Prior to foreclosure, NAMAIL's loan asset of €500 million would be written down in its balance sheet to €400 million, the value of the underlying collateral, using a revaluation account which has no impact on the Government deficit. The loan foreclosure would then be treated as two transactions namely (1) the imputed repayment of the €400 million loan, which has no impact on the deficit, followed by (2) the acquisition of the €400 million worth of non-financial assets used as collateral which, as mentioned above, will impact on the deficit. The net effect in this case is that the deficit is therefore worsened by €400 million. When NAMAIL sells the non-financial assets at a later date, it acquires cash of €400 million, improving the deficit once more. If these transactions took place in different years there would have been an artificial timing impact, with the GGDeficit worsening in the year the assets were acquired and improving in the year the assets were sold. The scale of loan foreclosures is so large that such timing differences could have significantly distorted Ireland's GGDeficit levels if NAMAIL had been classified within the Government sector.

8 System of National Accounts 1993.

9 See Annex for accounting example.

An added complication is that the GGDeficit would only have been affected if the land and property used as collateral were located in Ireland. In the ESA based national accounts, the ownership of land and property assets located in other countries is treated as an investment in a notional non-resident unit and is therefore considered to be a financial asset. This means that if on the foreclosure of a loan, the land and property acquired by NAMAIL is located overseas, its acquisition is treated in the national accounts as a financial transaction and would therefore not impact on the GGDeficit even if the agency was included in Government.

This potential for artificial distortions of the GGDeficit was avoided by having NAMAIL classified outside of the General Government sector. While this was not the criterion used for classification, it provides some support for the view that the extraordinary nature of the financial crisis and its potential for distorting underlying trends in the Government finance statistics justifies the temporary adaptation of some of the ESA95 national accounting rules in order to provide more stable statistics for EDP purposes.

4.3 Public ownership of banks

By the end of July 2011, the Irish State had provided €64 billion of capital to the six Irish banks[10]. These large capital injections mean that most of these banks are now owned by the State. In January 2009, Anglo was the first bank to pass into public ownership. This was followed in the middle of 2010 by EBS and INBS, and at the end of 2010 by AIB. At the start of 2011 the Government announced plans for the orderly winding down of both Anglo and INBS. Their deposit books have since been sold and their other activities combined into a single company which will be renamed the Irish Bank Resolution Corporation (IBRC). This entity will manage and dispose of the remaining assets over an extended period of up to ten years. This bank cannot enter into new business but has maintained a number of liened deposits and can issue loans related to its existing business customers.

The results of the stress tests for the other four domestic banks were published on 31 March 2011. These indicated that in total these banks could require up to €24 billion extra capital to satisfy the enhanced capital levels set by the Financial Regulator. Bank of Ireland raised part of their capital requirement with an investment from the private sector. In July 2011, the State provided €17.6 billion to the banking sector to meet the remainder of their capital requirements.

Since the stress tests were completed, AIB and EBS have been merged. This merged entity, along with BoI and IL&P, continue to operate as active banks. These three companies are classified as Financial Corporations and are excluded from the General Government sector.

On the other hand, classification of IBRC has proved somewhat more problematic. The Manual on Government Deficit and Debt (MGDD) states that publicly-owned financial defeasance companies that are newly established to manage impaired assets should be included in the General Government sector if the Government is at risk for losses that might be incurred on the assets in the future. During the financial crisis, existing public banks have been restructured in different ways and, in some cases, what now remains appears to have more of the features of a defeasance vehicle than an active credit institution.

In an effort to ensure a harmonised treatment of these entities by EU Member States, Eurostat issued guidelines in March 2011 for classifying publicly-owned banks. The basic principle to be applied was that when publicly-owned banks which managed impaired assets were restructured and were no longer actively performing as banks, they should be treated as defeasance structures and reclassified to the General Government sector. These guidelines were applied for the first time in the EDP reports at the end of March 2011. In practice, the guidelines were interpreted by Eurostat to mean that entities that were on the list of Monetary Financial Institutions (MFIs) maintained by the European Central

10 These were AIB, BoI, IL&P, EBS, Anglo and INBS.

Bank should continue to be treated as credit institutions and remain classified outside of General Government. This is in line with the accounting rules specified in Paragraphs 2.41 and 2.49 of the European System of Accounts (ESA95).

However, this interpretation of the guidelines meant that entities that were in many respects very similar were classified differently in the Government accounts at end-March 2011. In Ireland's case, Anglo had retained its banking licence and continued to be included on the MFI list, so it remained classified in the Financial Corporation sector (S.12). However, in the UK, Northern Rock had been split into a good bank and a bad bank, and the latter no longer had a banking licence and was reclassified into the General Government sector (S.13). To ensure transparency, Eurostat, when publishing the results of the March 2011 EDP reports, included a paper[11] which described the classification of those publicly-owned banks in Member States that were considered borderline cases.

The classification of a bank inside or outside of General Government can have a very significant impact on the levels of GGDebt which are measured in the EDP reports. The definition of debt used for EDP purposes is gross debt. If a 'bad bank' is reclassified into the General Government sector, its loan liabilities become part of the GGDebt and even though it may hold assets of a comparable value, these cannot be netted from the GGDebt reported in the EDP tables.

The classification criterion based on the MFI list is specifically established in the ESA95 and cannot be ignored. In addition, one consequence of having a full banking licence is the requirement to maintain an adequate amount of capital reserves. The capital injected by the Irish Government is sufficient to ensure that the requisite levels of reserves are held, and this is deemed sufficient to absorb any future losses. Notwithstanding this, there continues to be official discussions on the best way of dealing in practice with borderline cases. However, as an overall principle, the ESA favours a recording of transactions based on the economic reality rather than on legal form, so in some respects the holding of a banking licence and inclusion on the MFI list may not be an appropriate classification criterion.

5 The Financial Crisis and User Government Data Requirements

As described in the previous sections, the interventions carried out by Governments in the banking sector as a result of the financial crisis have led to enormous challenges for statisticians in terms of statistical recording. The financial turmoil and sovereign debt crisis however, mean that statisticians also face challenges in terms of users' requirements. Users of Government statistics require transparent information on the treatment in Government accounts of interventions in the banking sector, as well as Government's off-balance sheet exposures. Moreover, the financial turmoil and sovereign crisis mean that users need more timely debt and deficit statistics. This section explores how current Government statistics meet these challenges.

Since October 2009, Member States are required to provide Eurostat with a supplementary table on the treatment in the statistics of Government interventions resulting from the financial crisis from 2007 onwards. These tables are publicly available on Eurostat's website and inform users of the impact of the financial crisis on debt and deficit, as well as off-balance sheet Government guarantees. Eurostat further increased the transparency of the impact of the crisis on Government finance statistics by publishing a note on the supplementary tables in April 2011, including details of the classification of publicly-owned financial institutions. The supplementary tables provide a transparent guide to the treatment of government interventions in the accounts. There are two caveats to the tables however,

11 http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/Background%20note_fin%20crisis_Apr%202011_final.pdf.

in terms of timeliness and frequency. The tables are updated by countries bi-annually as part of the EDP reporting at t+3 months and t+9 months. This means that the tables are not always up-to-date with the latest impact of Government interventions on the statistics.

In the current economic environment, users require timely statistical information on Government finances. Currently, Member States are obliged to compile all government finance statistics at t+90 days. Under the forthcoming amendment of the EU Commission regulations governing this transmission however, there is scope for Member States to reduce the number of days at which they must provide Government statistics. While timelier data is of course desirable from the end-user's point of view, the potential impact this may have on quality must also be considered. Furthermore, there is a clear need for consistent treatment of relatively similar support measures across countries. The existing Eurostat proposals for re-routing assets and liabilities of bad banks through Government may enhance consistency, though major challenges remain for statisticians with regard to the issue of the valuation of impaired or illiquid assets.

6 Conclusion

Over the past three years, Government finances across the EU have undergone rapid change. All countries have seen their debt and deficit increase from 2007 levels. In addition, 20 of the 27 Member States have intervened to support the banking sector. It is clear however, that the impact of the financial crisis has not been homogenous across countries. In Ireland, fiscal imbalances resulting from the recession and the overexposure of Irish banks to the property market has meant that the support measures taken have been far more wide ranging and costlier than in other Member States. These have included guaranteeing the Irish banking sector, nationalising and restructuring distressed banks, creating an entity to manage impaired assets, and providing capital injections which so far total nearly 30 per cent of GDP. Our paper analyses the treatment of these measures in Government accounts. It shows that these interventions have increased debt by 5.3 per cent of GDP and 20.5 per cent of GDP for 2009 and 2010, respectively. In addition, the deficit was worsened by 2.5 per cent of GDP in 2009 and 20 per cent of GDP in 2010. The paper also highlights the ongoing issues at EU level to develop a framework to record all the diverse Government support measures for the financial sector, within a harmonised framework.

References

Honohan, P. (2009), 'Resolving Ireland's Banking Crisis', The Economic and Social Review, Vol. 40 No. 2.

Honohan, P., D. Donovan, P. Gorecki, and R. Mottiar (2010), 'The Irish Banking Crisis: Regulatory and Financial Stability Policy: 2003-2008', 31 May 2010, www.bankinginquiry.gov.ie.

Nyberg, P. (2011), 'Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland. Report of the Commission of Investigation into the Banking Sector in Ireland', March 2011, www.bankinginquiry.gov.ie.

Regling, K., and M. Watson (2010), 'A Preliminary Report on the Sources of Ireland's Banking Crisis', www.bankinginquiry.gov.ie.

ANNEX: Example of the recording of a loan foreclosure

After debtor default, NAMAIL forecloses on a loan of nominal value of €500 million which is backed by collateral in the form of property assets valued at €400 million. NAMAIL sells the property assets the following year also for €400 million.

Year 1

Opening Balance Sheet

NAMAIL: *Assets*		NAMAIL: *Liabilities*		Debtor: *Assets*		Debtor: *Liabilities*	
AF.4 Loans	500					AF.4 Loans	500

Balance sheet adjustment prior to foreclosure

Revaluation Account

NAMAIL: *Assets*		NAMAIL: *Liabilities*		Debtor: *Assets*		Debtor: *Liabilities*	
AF.4 Loans	-100					AF.4 Loans	-100

Adjusted Balance Sheet

NAMAIL: *Assets*		NAMAIL: *Liabilities*		Debtor: *Assets*		Debtor: *Liabilities*	
AF.4 Loans	400					AF.4 Loans	400

Recording of foreclosure

Capital Account

NAMAIL: *Uses*		NAMAIL: *Resources*		Debtor: *Uses*		Debtor: *Resources*	
P.51 Cap Formation	400					P.51 Cap Form	400
B.9 Net lending(+)/ borrowing(-)	-400			B.9 Net lending(+)/ borrowing(-)	+400		

Finance Account

NAMAIL: *Uses*		NAMAIL: *Resources*		Debtor: *Uses*		Debtor: *Resources*	
F.4 Loans	-400					F.4 Loans	-400
		B.9 Net lending(+)/ borrowing(-)	-400			B.9 Net lending(+)/ borrowing(-)	+400

Closing Balance Sheet

NAMAIL: *Assets*		NAMAIL: *Liabilities*		Debtor: *Assets*		Debtor: *Liabilities*	
AN.11 Fixed assets	400						

Year 2			
NAMAIL		**Debtor**	
Opening Balance Sheet			
Assets	*Liabilities*	*Assets*	*Liabilities*
AN.11 Fixed assets 400			
Capital Account			
Uses	*Resources*	*Uses*	*Resources*
	P.51 Cap Formation 400		
B.9 Net lending(+)/ borrowing(-) +400			
Finance Account			
Uses	*Resources*	*Uses*	*Resources*
F.2 Cash +400			
	B.9 Net lending(+)/ borrowing(-) +400		
Closing Balance Sheet			
Assets	*Liabilities*	*Assets*	*Liabilities*

The codes used in the above accounting example are described in the European System of Accounts (ESA95) Manual. B.9 Net lending(+)/borrowing(-) of the General Government sector corresponds to the General Government Deficit/Surplus. In the above example, if NAMAIL was included in the General Government sector, the GGDeficit would be worsened by €400 million in year 1 and improved by the same amount in year 2.