F.9 Valuation of Loans (Fair Value)

International Workshop on the Update of the System of National Accounts, 2008

Kunming, China
8 September 2022

Background

- *BPM6/2008 SNA* Valuation of loans at nominal value could be seen as a deviation from the general *BPM6/2008 SNA* principles, influenced by practical concerns…
- …including those on data availability and on the way to easily ensure symmetry between debtors and creditors.
- Nominal value can be defended as an approximation in the absence of standard markets. However, *"it is recognized that nominal value provides an incomplete view of the financial position, particularly when some loans are nonperforming"* (MFSMCG, 5.123).

Other reasons to consider changes

- Review process leading to the 2008 SNA completed before the outbreak of the 2008 great financial crisis and subsequent long-term effects. Need for guidance on several issues highlighted by the crisis, and related policy responses.
- Traditional preferences for preventing underestimation of debt have been challenged by the need to avoid optimistic views on the creditor side.
- Post-2008 events and financial stability studies stressed the need for not overestimating assets.
- Memorandum items are better than nothing. But they are not reflected in the main balancing items: change in net worth may be considerably distorted.

Options 1 – Maintaining the nominal valuation

- **Option 1a:** Do not change the current valuation of loans (status quo)
  - Leave in the updated SNA and BPM the provisions recommending that loans be recorded in the balance sheets of both creditors and debtors at nominal value.
- **Option 1b (recommended):** extend the existing guidance within the limits of the existing framework.
  - Nominal valuation allowing for value resets, in extraordinary events publicly known.

Options 2 – Shifting to fair valuation

- **Option 2a:** Change the existing valuation rules in the updated SNA and BPM, shifting to a simplified estimate for fair value, based on **nominal value less expected loan losses**.

- **Option 2b:** Change the existing valuation rules in the updated SNA and BPM, shifting to full **fair valuation at any time** for all loans in the core accounts.

The solution approved (1b)

- The selected Option 1b (nominal adjusted for extraordinary events) does NOT involve regular use of provisions for impaired loans or updates in the discount rate, implying revaluations of loans even in the absence of transactions. Loan values are revised **<u>ex-post</u>** (after the fact), **only in cases of extraordinary events or formal procedures**.

- Compared to alternatives, this solution is less aligned with the general principle of market valuation in the SNA and BPM, as well as available business accounting data.

- Its **main advantage** is improving measurement of financial positions, notably for fiscal and financial stability analysis. Minimizing the burden of changing the current practice and risk for inconsistencies at the cross-country level

So, when is market valuation of loans guaranteed ?

- The current rules (1a), while preventing continuous updates based on estimates, explicitly allow for value reset in **3 cases: <u>bankruptcy</u>, <u>liquidation</u> and other factors (=<u>court orders</u>)**. The issue of creditor/debtor symmetry is addressed by imposing the creditor view to counterparties, “to maintain balance in the accounts of the total economy” (SNA §12.40).

- The recommended option (1b) extends this approach beyond simple cases (bankruptcy, liquidation and court orders). The same logic would be applied to other cases of **reassessment of loans by a formal, publicly known process** (e.g. in the context of bank recovery operations, imposing on shareholders to absorb a corresponding loss). The set of relevant cases should then be increased, but clearly ring-fenced.
- **Apart from these cases, loans shall still be recorded at nominal value, and standard provisioning would not affect balance sheets**. Symmetry achieved as in 1a (creditor view).

Thank you for your attention !