CENTRAL BANK OF ICELAND
Statistics and IT Department

Quarterly financial accounts for financial institutions in Iceland

The Central Bank of Iceland has begun publishing on its website the financial accounts of Icelandic financial institutions from Q4/2003 onwards. Financial accounts are a part of national accounts calculation, which is carried out according to harmonised international accounting methods and provides an exact overview of the Icelandic economy and Iceland's trade with other countries. Iceland has not published information in this form before, but the practise is well known in other countries and is included in international standards for statistics. The financial accounts will facilitate statistical comparison with other countries[1]. At first, data from 2003 onwards will be published and updated on the Bank's website with a time lag of about 10 weeks. The financial accounts will supplant the credit system accounts that were published on a quarterly basis from 1991 to mid-2008. There are some methodological differences between the two methods; thus it is not possible to compare credit system accounts with the financial accounts. The chief difference is that Treasury foreign borrowings are listed under the public sector, whereas they were previously listed under credit systems. In addition, internal transactions between parties were deducted in credit system accounts, while this is not done in financial accounts calculation.

Financial accounts for financial institutions are prepared from the balance sheet summaries of the Central Bank of Iceland, deposit money banks (DMBs), pension funds, insurance companies, miscellaneous credit institutions, and mutual and investment funds. In addition, Government-administered credit funds[2] and financial institutions in winding-up proceedings or composition of creditor's negotiations[3] are included among financial institutions while they retain their operating licences from the Financial Supervisory Authority (FME).

The financial accounts are prepared in co-operation with Statistics Iceland, which oversees the project. The division of tasks between these institutions is carried out so that Statistics Iceland handles the accounts of households, the public sector, and non-financial corporations, while the Central Bank handles external accounts and financial institutions' accounts. At a later date, Statistics Iceland will publish a summary of financial accounts for the general economy and each individual sector. Financial accounts are structured so that one party's assets are another party's liabilities, and all amounts are sorted by counterparty. When financial accounts calculations covering all economic sectors are published in their entirety, it could therefore affect the financial accounts for the financial institutions, and some variables could change. This will not affect lending or deposits, however. An example is household deposits with credit institutions. Households' deposits are classified as currency and deposits on the assets side of household accounts, while they are classified as liabilities in the credit institutions' accounts and entered as currency and deposits there.

[1] The financial accounts on the OECD's website.
[2] These credit funds are the Icelandic Student Loan Fund, Orkusjóður, the New Business Venture Fund, and the Depositors' and Investors' Guarantee Fund.
[3] List of financial institutions in winding-up proceedings or composition of creditors negotiations.

Financial accounts are prepared using international methodology, according to the EU's European System of Accounts, ESA95.[4] Financial accounts show capital flows between economic sectors and with other countries. Only financial assets and liabilities are included. As such, real estate, landholdings, and operational assets such as inventories are not part of the financial accounts. The financial accounts contain financial assets and liabilities of individual economic sectors, classified by counterparty, and capital flows between these sectors. The Central Bank publishes only balance sheet stocks at present, however. All amounts in the financial accounts are presented at the current year's price level.

Parties to the financial accounts

- The banking system: The Central Bank of Iceland, commercial banks, and savings banks.
- Other financial institutions: Miscellaneous credit institutions such as investment banks, credit undertakings, the Housing Financing Fund and the Institute of Regional Development, mutual and investment funds, Government credit funds, and financial institutions in winding-up proceedings or composition of creditors negotiations[5].
- Pension funds and insurance companies: Pension funds and insurance companies, both non-life insurance and life insurance companies.

The counterparts in financial accounts are classified in the following five economic sectors:

- Public sector
- Households
- Non-financial corporations
- Financial institutions
- Foreign countries

In ESA95, it is assumed that all financial products are valued at market value.[6] Financial assets and liabilities are divided into seven types of financial products:

- Monetary gold and special drawing rights (SDR) with the International Monetary Fund (IMF)
- Currency and deposits
- Securities other than shares
- Loans[7]
- Shares and other equity
- Insurance technical reserves
- Accounts receivable/payable

[4] The European Union's national accounts standard, ESA95, is based on SNA 1993, the international national accounts standard of the United Nations (UN) and thereupon International Monetary Fund (IMF).
[5] In the data for financial institutions in winding-up proceedings or composition of creditors negotiations information are missing from SPRON, BYR and SpKef.
[6] It is difficult to estimate the market value of shares in unlisted companies. International standards recommend that companies listed on the exchange be used to approximate the value of unlisted companies. The Icelandic equity market is very small, however, and this method is not viable. It has therefore been decided to record unlisted shares at book value.
[7] Loans are valued at book value, that's the value that reflects the amount that is expected to be recovered from the loans.

Table 1 shows a summary of the financial accounts for the second quarter of 2011. Financial system assets totalled 10,906 b.kr. at the end of second quarter 2011, including loans[8] amounting to 4,213 b.kr., or just under 39%. Financial system liabilities totalled 15,365 b.kr., including deposits amounting to 4,429 b.kr., or just under 28%. A large share of the financial system's financial assets and liabilities are with financial institutions in winding-up proceedings or composition negotiations. These companies' assets amounted to almost two times GDP as of the end of second quarter 2011. Their liabilities are considerable; for example, their negative equity amounted to over six times GDP. The table also shows totals excluding financial institutions in winding-up proceedings or composition negotiations, as these firms will disappear from the financial accounts once their estates have been settled.

Excluding the financial institutions in winding-up proceedings or composition negotiations, the banking system comprises the largest part of the financial system, with over 51% of financial assets. In second quarter of 2011, the banking system funded itself primarily with customer deposits. About 45% of the banking system's financial assets were loans, and 31% were securities.

The assets of pension funds and insurance companies consist primarily of marketable securities and equity capital. Loans granted by these firms constituted about 9% of their financial assets as of second quarter of 2010.

Table 1. Financial accounts for financial institutions, by type of institution – 2. Quarter 2011

M.kr.	Banking Sector	Other Financial Institutions	Thereof companies in liquidation or compostition memorandium	Pension Funds and Insurance Companies	Totals	Totals without companies in liquidation or compositition memorandium
Total Financial Assets	**4.065.954**	**4.588.828**	**2.992.534**	**2.250.731**	**10.905.514**	**7.912.979**
Monetary gold and SDRs	22.127	.	.	.	22.127	22.127
Currency and Deposits	786.362	850.281	776.743	165.198	1.801.842	1.025.099
Securities other than shares	1.243.423	754.165	480.961	1.155.780	3.153.369	2.672.408
Loans	1.827.241	2.189.693	1.017.548	196.204	4.213.138	3.195.590
Shares and other equity	160.877	757.143	716.983	696.638	1.614.657	897.674
Insurance technical reserves	0	0	0	3.458	3.458	3.458
Accounts Receivable	25.923	37.546	299	33.453	96.923	96.623
Total Liabilities	**4.090.539**	**11.050.295**	**9.552.047**	**223.709**	**15.364.542**	**5.812.495**
Currency and Deposits	2.589.847	1.839.574	1.839.574	0	4.429.421	2.589.847
Securities other than shares	132.297	2.028.780	1.144.234	74.899	2.235.976	1.091.742
Loans	771.703	6.332.221	6.106.737	0	7.103.924	997.187
Shares and other equity	467.650	346.078	0	59.509	873.237	873.237
Insurance technical reserves	0	0	0	79.636	79.636	79.636
Accounts Payable	129.041	503.642	461.501	9.665	642.348	180.847
Net financial assets	**-24.585**	**-6.461.466**	**-6.559.513**	**2.027.023**	**-4.459.029**	**2.100.484**

Source: The Central Bank of Iceland

[8] In these figures, the loans of Arion Bank hf., Íslandsbanki hf., and NBI hf. are assessed at purchase value; that is, the price at which these parties purchased the loan portfolio from Kaupthing Bank hf., Glitnir Bank hf., and Landsbanki Íslands hf. The purchase value is the amount that is expected to be collected on the loans.

Table 2 shows the financial institutions' financial accounts, classified by economic sector. As is stated above, one party's assets are another party's liabilities. Financial institutions' assets from households – or households' debts to financial institutions – are estimated at 1,507 b.kr., or slightly less than GDP. Of that total, loans to households are estimated at 1,490 b.kr. Financial institutions owe households 622 b.kr. in deposits with DMBs and currency issued by the Central Bank of Iceland along with 79. b.kr. in insurance assets with insurance companies. Financial institutions' assets from corporations were estimated at 2,016 b.kr. Financial institutions' financial assets and liabilities abroad are all placed in one category – foreign countries – and not classified by country. Financial institutions have loans abroad amounting to 5,520 b.kr., the majority of them to financial institutions in winding-up proceedings or composition of creditors negotiations.

Table 2. Financial accounts for financial institutions, by counterparty – 2. Quarter 2011

	Counterpart					
M.kr.	Non-financial corporations	Financial corporations	Government	Households	Abroad	Totals
Total Financial Assets	**2.015.980**	**3.015.911**	**890.510**	**1.507.356**	**3.475.757**	**10.905.514**
Monetary gold and SDRs	.	.	.	.	22.127	22.127
Currency and Deposits	0	688.728	0	0	1.113.114	1.801.842
Securities other than shares	282.394	1.424.730	786.706	0	659.538	3.153.369
Loans	1.374.097	531.731	102.961	1.489.980	714.369	4.213.138
Shares and other equity	320.948	328.374	449	0	964.886	1.614.657
Insurance technical reserves	0	0	0	3.458	0	3.458
Accounts Receivable	38.540	42.348	393	13.918	1.723	96.923
Total Liabilities	**479.497**	**4.870.381**	**651.409**	**709.988**	**8.653.267**	**15.364.542**
Currency and Deposits	467.300	987.908	485.049	622.407	1.866.756	4.429.421
Securities other than shares	4.015	1.321.571	232	0	910.159	2.235.976
Loans	0	1.447.408	136.371	0	5.520.146	7.103.924
Shares and other equity	0	873.237	0	0	0	873.237
Insurance technical reserves	0	0	0	79.636	0	79.636
Accounts Payable	8.181	240.257	29.758	7.945	356.206	642.348
Net financial assets	**1.536.483**	**-1.854.470**	**239.100**	**797.368**	**-5.177.510**	**-4.459.029**

Source: The Central Bank of Iceland

Lending to households and non-financial companies

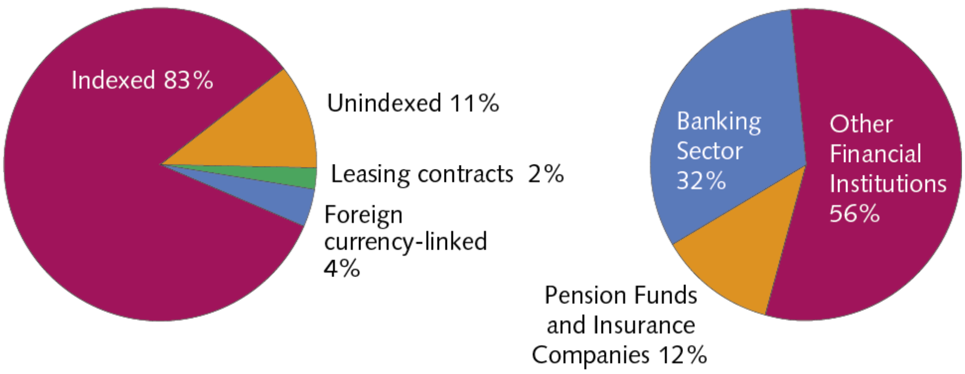
Tables showing lending to households and businesses will be released concurrent with the publication of financial accounts. Because of extraordinary circumstances that have dominated the Icelandic credit market as a result of the financial crisis of October 2008, loans granted have been entered at book value in the financial institutions' accounts; that is, loans have been recognised at the value at which the banks purchased the loan portfolio and should reflect expected recovery. Until all loans have been restructured, the book value does not reflect the borrowers' actual debt to the financial institutions. Loan portfolio values are re-evaluated on a quarterly basis and may increase or decrease as the financial institutions' estimate of payment flows on the loans changes. They may also change when loan restructuring yields a balance that differs from book value. Also shown is the credit provisioning account, which shows precautionary entries in connection with lending.

When the banks collapsed in October 2008, a portion of the failed banks' deposits and loans were transferred by administrative decision to the new banks established on the foundations of the failed institutions. The rule of thumb was that domestic deposits and loans were transferred to the new banks. This practise was not followed in all cases, however. Some loans to residents of Iceland remained in the old banks, together with loans to non-residents. It should also be borne in mind that, upon the collapse of the banks, a portion of the loan portfolios had been transferred to special purpose vehicles (SPVs), which then issued bonds secured by the loan portfolios in question.[9] These instruments are often called collateralised debt obligations (CDOs). The SPVs were both domestic and foreign entities. The CDOs remained in the failed banks and are recognised as holdings in the SPVs, not as loans. Figures showing loans to businesses and households therefore do not provide a comprehensive view of lending to these entities. When the operating licences of the financial institutions in winding-up proceedings are revoked by the Financial Supervisory Authority (FME), the institutions will no longer be classified as financial institutions but as holding companies. At that point, their loans will disappear from the tables showing financial institutions' loans and be transferred to the corporate sector. At the end of Q2/2011, three licensed financial institutions were in winding-up proceedings: Kaupthing Bank, Landsbanki Íslands, and Glitnir.

Chart 1 shows financial institutions' lending to households, classified by lender and by type of loan, as end of 2. quarter 2011. It is not possible to swap leasing contracts for exchange rate-linked, indexed, or non-indexed loans; therefore, they are shown separately. The largest lender to households is *other financial institutions*, with 56% of lending. The Housing Financing Fund and the Icelandic Student Loan Fund are most prominent in that group. The banking system accounts for about 32% of lending to households. The vast majority of loans to households (83%) are indexed.

Chart 1.

Lending to households as of Q2/2011



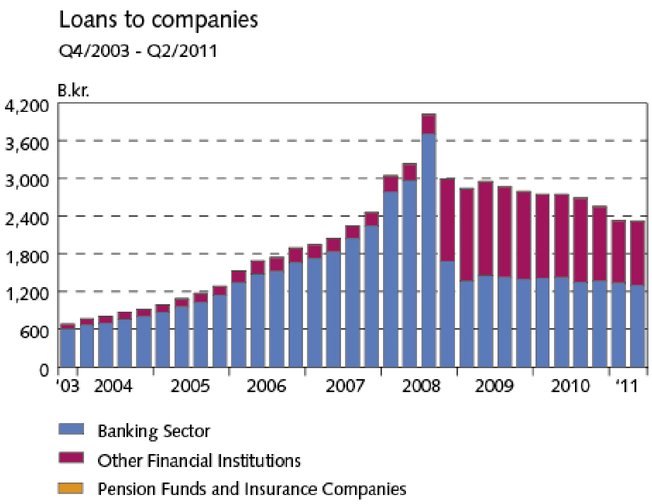
Source: Central Bank of Iceland.

Chart 2 shows financial institutions' lending to corporations from year-end 2003 until the end of June 2011. Until Q3/2008, the banking system was the largest lender to corporations. A portion of corporate loans were transferred after the commercial banks failed. Some loans remained with the winding-up committees of the failed banks and were thereby transferred between sectors, from *deposit money banks in winding-up proceedings* to *miscellaneous credit institutions*.

[9] In some instances, the bookkeeping entries had not been completed by September 2008; therefore, the loans were still on the loan books of the parent companies when the banks failed but were recognised as holdings in SPVs in the December 2008 accounts of the financial institutions in winding-up proceedings.

The loans of parties transferred to the new banks have remained in the sector entitled *banking system*, however.

Chart 2.



Source: Central Bank of Iceland.