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Ms Gabriella Vukovich
President
Hungarian Central Statistical Office
Keleti Károly u. 5-7.
1028 Budapest
Hungary

Subject: Statistical classification of Eximbank

Ref: Dialogue visit discussion of 10-11 June 2014
Your note provided on the classification of MFB and Eximbank on 29 August 2014
Further information provided on 15 January 2016
Your note on 5 February 2016
Your e-mail on 9 February 2016
Dialogue visit discussion of 16 February 2016
Our letter of 21 March 2016
Your letter of 31 March 2016

Dear Ms Vukovich,

Thank you for your analysis of the case of Eximbank, provided in your letter of 31 March 2016. Please find below our reply to the various points you raise in your letter and our conclusion on the basis of the information at our disposal.

The first three points mentioned are that Eximbank has the features of an institutional unit, it is a financial corporation and more specifically a financial intermediary. In fact these three points could only follow as conclusions, after the particular characteristics of Eximbank are properly analysed and all applicable rules of ESA2010 and the MGDD are tested. Therefore, we concentrate below on the remaining arguments of your letter and the specific characteristics of the unit.

As already stated in our letter of 21 March 2016, Eximbank is a public unit in the sense that it is an incorporated entity 100% owned by government. In order to decide on the classification of this unit, one must analyse Eximbank in view of the ESA and MGDD rules, including also

Commission européenne, 2920 Luxembourg, LUXEMBOURG - Tel. +352 43011
Office: BECH D4/733 - Tel. direct line +352 4301-35402 - Fax +352 4301-35199

<http://epp.eurostat.ec.europa.eu>
eduardo.barredo-capelot@ec.europa.eu

the rules on captive financial institutions. The same approach has been applied in all other similar cases in other member states.

The first argument in your letter is that "Eximbank is a monetary financial institution and as such should be classified in the S.122 subsector".. In your letter you refer to ESA2010 2.76 and 2.77 to support your analysis. We consider by contrast that ESA 2.76 supports our view, given that, as noted in this article, the fact that a unit is called "bank" is not relevant; the decisive factor is whether or not the unit is a deposit-taking corporation. Given that Eximbank does not take deposits it cannot be classified in S.122.

Although ESA2010 2.77 mentions deviations from the general ESA definition, these concern only two specific exceptions:

"... (a) corporations engaged in granting mortgages (including building societies, mortgage banks and mortgage credit institutions);

(b) municipal credit institutions..."

Eximbank does not belong to either of these categories and therefore it cannot be classified in S.122. As stated in the MGDD and in some guidance notes made public by Eurostat, units which have the features of captive financial institutions controlled by government are to be classified inside government.

The second argument mentioned in your letter is that Eximbank performs financial intermediation, which automatically means that it performs a market activity, because it is assumed that financial intermediation is automatically considered as a market activity in national accounts. This argument is not accurate, for the reasons explained below.

SNA2008 A3.28 is put forward to support the view that financial intermediation always "represents market production". Please note that this paragraph refers to the specific case of Central Banks and, in any case, SNA2008 does not say that financial intermediation always represents market production for all entities. It would seem on the contrary more in line with the spirit of the system to verify that the financial intermediation services are indeed carried out on a commercial basis, in a manner that meets the "economically significant" criteria of the pricing of market output.

Generally speaking, it is not correct that in national accounts any activity which has the characteristics of financial intermediation is automatically considered as a market activity. It cannot be excluded that an activity having the characteristics of financial intermediation is performed on non-market terms. Even assuming that financial intermediation was defined as a market activity in national accounts, Eximbank's production, as shown in our letter of 21 March 2016, is most likely negative in national accounts terms. This would lead to an obvious contradiction of negative market output.

SNA 6.151 explains that financial intermediation is market output as such services are individual in nature "in the absence of policy intervention in the interest rate charged", which

may be interpreted as excluding cases of subsidised rates or rates not aligning with market practices.

It is therefore a matter of interpretation that cases of activities seemingly dealing with financial intermediation but translating into negative margins be classified as nonmarket financial intermediation or as other activities.

Therefore, the substance of the activities of Eximbank must be analysed first and it is not possible to automatically conclude that a unit performs financial intermediation on market terms, simply because *it appears* that the unit is a financial intermediary. This analysis should also include the rules on captive financial institutions.

The third argument in your letter is about the subsidy on the interest rate. We understand that this subsidy is calculated by client and by loan. We also understood from our discussions during the last dialogue visit that the financing cost of the bank is also taken into account in calculating the subsidy. The argument that Government is in fact subsidising the exporter, not Eximbank, and therefore government subsidies on interest should be considered as interest revenue of Eximbank, is doubtful.

Let's assume for the sake of the argument that government is in fact subsidising the exporters. This would mean that Eximbank is a unit created and owned 100% by government to carry out government policy, i.e. to collect subsidies from government (in various forms) and to redistribute them to final beneficiaries. It could be considered that indeed Government's initial purpose in this case is to provide a subsidy to the exporter. Government could choose a number of ways to realise this policy: e.g. the subsidy could be provided via commercial banks. The existence of an entity such as Eximbank is not necessary. In this case, government has established a specialised entity (Eximbank) whose only purpose is to provide such financing to exporters, on the basis of the fact that government will (always) subsidise the interest rate. Indeed, Eximbank does not have significant other sales through a genuinely market type of activity. For this reason, its real FISIM is negative. If these subsidies are considered towards the exporters, Eximbank's FISIM appears positive, but the entity has in fact the main function of distributing government's subsidies, i.e. its main function would be to execute government policy. Therefore, in that case too, Eximbank would be classified in S.13 as an ancillary unit of government.

The fact that Eximbank has large liabilities and assets, as a way to de facto distribute government subsidies, does not change the analysis because, at the same time, all the liabilities of Eximbank are guaranteed by Government, and government controls both its assets and the general policy (as shown in our letter of 21 March 2016).

Moreover, in your letter you refer to ESA2010 4.37c to support the view that the subsidies should be treated as a subsidy to the exporter. However, ESA2010 4.37c concerns cases where government aims at alleviating the cost of borrowing of identified borrowers by paying the difference between the interest charged and the market rate. In the case of Eximbank, the difference paid by Government is the difference between the interest charged and the cost of Eximbank. Indeed, the difference between interest charged and cost can be split into a

difference between interest charged and market rate on the one hand, and a difference between market interest on the assets of Eximbank and the borrowing cost of Eximbank on the other hand. The first component can be viewed as a subsidy to the exporter and the second as a subsidy to the bank itself.

In other words, no matter how one looks at the issue, the main fact remains that Eximbank is a unit created by government whose main function is to either distribute subsidies to exporters or to fund exporters at a loss. In all cases, Eximbank does not have a genuine market activity.

The final point of your letter is that the MGDD chapter I.6.6 is not applicable in cases of financial corporations which have a complex organisational structure, staff and sales revenue. However, as already pointed out in our letter of 21 March 2016, there are indeed cases where a unit, which at first sight appears to be an institutional unit, after careful analysis is in fact revealed to be a captive. The fact that a unit is complex and employs staff (therefore not being an SPE or a "shell") is not an automatic, sufficient condition to determine whether or not a unit is a captive, or an ancillary unit for that matter.

The decisive criterion is whether or not the unit has enough independence from its parent as demonstrated by effective and substantive control over its assets and liabilities to the extent that it is genuinely exposed to the risks and rewards on them (ESA2010 2.22). As clearly argued in our letter of 21 March 2016, Eximbank does not have effective control of its assets and liabilities. Instead it relies on government, and it should therefore be considered as a captive of government, to be classified in S.13.

To conclude, for the reasons stated above and in our advice letter of 21 March 2016, and taking into account also the arguments presented in your letter of 31 March 2016, Eurostat still considers that Eximbank is a captive financial institution of government, to be classified in S.13.

Yours sincerely,

(eSigned)

Eduardo Barredo Capelot
Director