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Directorate D: Government Finance Statistics (GFS) and quality

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Mr Vitezslav Ondrus
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Czech Republic

Subject: Statistical treatment of the Czech Export Bank

Ref: your emails sent on 24 March 2014 and 14 April 2014 and additional information sent in your email of 30 May 2014

Dear Mr Ondrus,

Thank you for the information which was provided to us by the Czech statistical authorities on the recording of the Czech Export Bank (CEB) in national accounts and EDP tables. After a careful examination of the issue by Eurostat, I am now in a position to provide an opinion on the statistical treatment of the CEB in national accounts.

The accounting issue

The issue for which an opinion is being sought is the statistical classification of the CEB and the statistical treatment of its operations in national accounts and in EDP reporting under the current applicable rules of the ESA95 methodology and in the light of the forthcoming ESA 2010.

Documentation provided

The Czech statistical authorities provided to Eurostat in their first email of 24 March 2014, a detailed description of the CEB and of its activities, including two different proposals for the statistical recording. In a second email received on 14 April 2014, the Ministry of Finance of the Czech Republic proposed a third option for the statistical classification of the CEB.

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Description of the case

The CEB was established by Law No. 58/1995 on insurance and financing of export with a state support. The main objective is to implement export financing through the provision of loans at interest rates below market rates (so-called scheme 002) and the provision of bank guarantees. Apart from the export financing subsidized by the government, the CEB runs also some profitable banking activities (scheme 001). For both schemes, a separate accounting is kept by the bank. The CEB has a banking licence and is fully owned by the government. The majority of the Supervisory Board are representatives of ministries, as shareholders.

The main source of financing is through the issuance of bonds on the financial markets. The rating of the bonds issued by the CEB is very close to the rating of government bonds. As stipulated by the Law, all financial sources (liabilities) of the CEB are guaranteed by the government. Until now, the guarantee has not been called. Currently, the bank is classified in the financial corporation sector (S.12201).

Methodological analysis and clarification by Eurostat

Applicable accounting rules

Paragraphs 2.26 about the government control and 2.32 to 2.33 about Financial corporations of ESA95 chapter 2 and part I.5 of the ESA95 Manual on government deficit and debt (MGDD) about Units engaged in financial activities: ‘general issues’ are applicable in this case. From 1 September 2014, the equivalent paragraphs 2.35 and 2.38 on government control and paragraphs 2.56 and 2.57 of the ESA 2010, as well as part I.5 Units engaged in financial activities: ‘general issues’ will be applicable. In addition, guidance provided by the MGDD in part I.6, ‘Specific public entities on Captive financial institutions’ will be relevant.

Availability of national accounting analysis

In their analysis, the Czech statistical authorities presented the statistical implications of the case according to the ESA 2010 methodology and considered that, under the present status of the entity, the CEB has the characteristics of a government unit, not complying with the ESA rules, in order to be a financial intermediary. At the national level, this preliminary analysis was supported by the Czech National Bank, which pointed at the fact that the classification of the CEB should be narrowly linked to the discussions on possible changes in the CEB status. No particular details were provided to Eurostat on these possible future changes. In the analysis received on 24 March 2014, two proposals for the recording including the preliminary impact on deficit/debt, were provided:

- Option 1: Reclassification of the CEB to the general government sector (S.13)

- Option 2: Re-routing of the flows and stocks related to the subsidized scheme 002 to the government accounts

The additional document sent by email on 14 April 2014 presented the position of the Ministry of Finance of the Czech Republic. In this respect, a third different proposal for the statistical classification of the bank was provided to Eurostat which does not foresee any change to the current classification:

- Option 3: Classification of the CEB in the financial corporations sector (S.12201)

Additional information on the level of autonomy of decision in the process of loans provision by the CEB was also provided upon Eurostat's request in the email sent on 30 May 2014.

Analysis

The CEB is established according to the special Law on insurance and financing of export which defines its status and activities in the field of pro-export policy. According to the Law, the pre-condition for subsidized export financing provided by government is a minimum proportion of shares in the Bank's capital of two thirds owned by government with the remaining capital owned by the export insurance company, which is also owned by the State. Currently, government owns 80% of the shares of the Bank and the export insurance company owns the remaining 20% of the capital. In addition, the Law states the preferential distribution of the bank profit and limits the bank participation in the capital of other corporations. The Supervisory Board mainly consists of the representatives of ministries as shareholders who execute control over the corporation activities.

The main purpose of the CEB is to support the Czech exports and to perform the government pro-export policy through the provision of low interest rate loans subsidized by government or the provision of guarantees. In the framework of these non-profitable activities, the Bank keeps separate records in its accounting with the code 'scheme 002'. In addition, the Bank performs also other (profitable) business activities (scheme 001), as a financial institution. This, however, represents a minor part in the bank activity, as evidenced by the figures provided by the Czech statistical authorities in their analysis. According to the strategy endorsed by the shareholders, the main part of the activities is focused on the government pro-export policy and the support of export financing, i. e. on the provision of loans subsidized by the government. The Law defines a direct link of the government subsidized export financing with the State Budget.

Government, represented directly by the ministries as shareholders, and indirectly through the state-owned export insurance company, exercises control over the CEB through the ownership of more than half the voting rights and control of the Supervisory Board. As defined by ESA95 paragraph 2.26 (ESA 2010 paragraph 2.36), '*government secures control over a corporation by owning more than half the voting shares or otherwise controlling more than half the shareholder's voting power'*. A certain level of government decision-making in corporate policy and functions is also ensured by the existence of special legislation, as stated in the ESA95 paragraph 2.26 (ESA 2010 paragraph 2.38): '*In addition, government secures control over a corporation as a result of special legislation decree or regulation which empowers the government to determine corporate policy or to appoint the directors*. In case of the CEB, government provides financing through the guarantee on liabilities incurred by the CEB on financial markets and directly by covering the losses resulting from the great majority of the Bank's activities, i. e. subsidized export financing.

Furthermore, as stated by the Czech authorities, the provision of loans exceeding the principal value of 500 million CZK has to be approved by the Supervisory Board. Currently, it concerns two thirds of the loans granted by the CEB. This rule applies to both 'schemes' performed by the CEB. In addition, all transactions of strategic importance have to be consulted with the government. It was stressed by the Czech authorities, in this respect, that the territorial structure of the CEB's loan portfolio follows the government strategy which indicates a predefined group of countries as the loan beneficiaries. It is therefore evident that the CEB hereby fulfils the role of a government agent entrusted with tasks in the context of public policy objectives, having a very limited autonomy of decision in its main corporate objectives.

In order to perform its activities, the CEB raises debt on the financial markets, mainly through the issuance of bonds. As confirmed by the Czech statistical authorities in their analysis, the rating of the CEB bonds is comparable to the rating of government bonds and, at the same time, it is more favourable than the rating of the largest banks of the Czech Republic. The Law also specifies that the agreement of the Ministry of Finance is needed in the case the CEB raises debt on the capital markets. In 2010, a loan and a capital injection were provided to the CEB by the Ministry of Finance. Following the results of the capital injection test, the capital injection was recorded in national accounts as a non-financial transaction. The loan was repaid in 2013. By Law, liabilities of the CEB related to repayment of debt and other operations incurred in financial markets, are guaranteed by government.

As defined by the ESA95 paragraph 2.33 (ESA 2010 paragraph 2.57), *'a financial intermediary does not simply act as an agent for these other institutional units but places itself at risk by acquiring financial assets and incurring liabilities on its own account'*. From the information provided above, it is clear that, for a predominant part of the CEB's activities, which are related to the subsidized export financing, it is government which bears the final risk and covers the losses resulting from the pro-export public policy, i. e. the provision of loans at interest rates below market rates. This argument is further emphasized by the fact that the liabilities of the CEB are explicitly guaranteed by government, as stipulated by the Law (as well as, implicitly, by the ministries as shareholders).

With respect to ESA 2010 guidance, the CEB seems to have the features of a captive financial institution, as defined in the ESA 2010 paragraphs 2.21 – 2.23. As explained beforehand, the CEB is not engaged in financial intermediation, but acquires the financial resources for its activity from its 'sponsor' by way of direct financing or by the provision of a guarantee. By means of certain limitation in the CEB's decision making on the granting of loans or on the selection of beneficiaries, the government executes the control over the assets of the CEB. Consequently, the independence of the CEB in decisions of corporate policy is very limited. Moreover, it was pointed out by the Czech authorities that several significant changes are being discussed at the national level which might lead to an even more extended government control of the CEB in the future.

In this context, Eurostat considers that, with regard to the fact that the CEB does not comply with the definition of the financial intermediary and it is controlled by the government, with a limited autonomy of decision in main corporate policy, the CEB is to be reclassified in the general government sector (S.13) according to ESA 2010 rules.

Conclusion

On the basis of the above considerations, Eurostat concludes that the CEB is not a financial intermediary placing itself at risk, when performing the public policy activities on behalf of the government. In addition, the CEB complies with the ESA definition of control (by government), in particular through government ownership of the majority of voting interest, government control over the Supervisory Board and the fact that the financing is mainly provided by government. Therefore, Eurostat agrees with the first option proposed by the Czech statistical authorities that the CEB is a government controlled entity which is to be classified in the general government sector (S.13).

Furthermore, in the light of the ESA 2010, the CEB seems to be a captive financial institution, classified inside the general government sector (S.13).

Procedure

Eurostat is prepared to give a preliminary view on the statistical classification of such operations provided that it is in possession of all of the necessary background information. The preliminary view is given in accordance with the guidelines for ex-ante advice published on the Eurostat web-site.

This preliminary view of Eurostat is based on the information provided by the country authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopting a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009, as amended, and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat intends, therefore, to publish all future official methodological advice (ex-ante and ex-post) given to Member States, on the Eurostat web site. In case you have objections concerning this specific case, we would appreciate if you let us know. In any case (regardless of whether you have objections or not) we would like to receive an answer from you on the issue no later than **20 June 2014**.

Yours sincerely,

(eSigned)

Eduardo Barredo Capelot
Acting Director