

Directorate D: Government Finance Statistics

Luxembourg, 27-03-2012
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Dr. Konrad Pesendorfer
Director General
Statistics Austria
Guglgasse 13
A-1110 Vienna
Austria

Subject: Treatment of capital injection ('Gesellschafterzuschuss') and state guarantee granted to KA Finanz AG

Ref: Request for consultation on recording of government liabilities resulting from the agreement between the Federal Republic of Austria and KA Finanz AG, received on the 7.03.2012 (via e-mail).

Dear Mr Pesendorfer,

In reply to the request for consultation on the recording of the capital injection and state guarantee agreed between the Federal Republic of Austria and KA Finanz AG in December 2011, I am in a position to inform you of Eurostat's opinion.

The accounting issue

The Statistical Authorities of Austria asked for clarifications on the application of the national accounting rules about the guarantee and capital injection granted to KA Finanz AG by the Federal Republic of Austria.

Documentation provided

The Statistical Authorities of Austria submitted a short description of the issue and a copy of the agreement between the Federal Republic of Austria and KA Finanz AG, involving the granting of a guarantee and the provision of a capital injection by the shareholders ('Gesellschafterzuschuss').

Description of the case

On 23 December 2011 an agreement was signed between the Federal Republic of Austria and the KA Finanz AG on a guarantee on assets and a capital injection.

Capital injection ('Gesellschafterzuschuss'):

The Austrian government granted a capital injection to KA Finanz AG for a yet undetermined amount but with an upper limit of about 610 million EUR, in order to cover losses incurred in the past. The purpose of the capital injected is to provide KA Finanz AG with equity which would

preserve its equity ratio, in order to be in line with specific banking sector requirements, following write-downs on bank's assets and risk provisions undertaken.

The agreement states that "the capital injection is granted as of 31 December 2011". The exact amount of the injection, however, will be determined only afterwards, in the context of the approval of the KA Finanz AG's financial statement for 2011, on 30 April 2012 at the latest. The actual provision of cash in the context of the injection will take place within 10 bank working days after that.

The guarantee:

The Federal Republic of Austria granted to KA Finanz AG a guarantee on some specific assets

[REDACTED]

The Austrian State guarantees the value of the assets for a maximum amount up to about 190.4 million euro in case of a guarantee call. The exclusive purpose of the guarantee is to preserve for KA Finanz AG the balance sheet value of these assets, so that no risk provisions had to be introduced in this respect. Therefore the guarantee is provided only for the assets that are to be included into the calculation of the credit risk exposure for the purpose of the minimum equity requirement, and classified by the bank auditor as in need of special risk provisions. The guarantee will be exercised by KA Finanz AG with a call upon the Austrian State to pay an amount up to the ceiling agreed. It will be effective according to law only upon a formal agreement by the Supervisory Board. The guarantee covers the losses on those assets, up to the difference calculated between their nominal value (book value as of 15.12.2011) and their market value.

Methodological analysis by Eurostat

After examination of the documentation provided, Eurostat has reached the following preliminary view.

Applicable accounting rules

The ESA95 Manual on Government Deficit and Debt (MGDD) chapters on: general government and public corporations, debt related transactions and guarantees and defeasance structures (as amended in the March 2012 edition).

Availability of national accounting analysis

The request for clarification includes a provisional assessment of the transactions in question.

Analysis

Background

According to Eurostat's understanding, at the moment of the signature of the agreement on the guarantee and on the capital injection by shareholders:

- the Republic of Austria was, and still is, a legal owner of 99.78% of equity of KA Finanz AG;
- KA Finanz AG benefitted since its nationalization in 2009 from a government guarantee – a debtor warrant of 1 billion euro granted by the Republic of Austria, [REDACTED] to Kommunalkredit AG. This was classified in national

accounts and for the purpose of EDP statistics as a capital transfer, increasing government expenditure in the year 2010;

- KA Finanz benefits also from government guarantees on their bonds and commercial papers issued – such guarantees are treated, in national accounts, as contingent liabilities, and thus have not been considered, up to now, neither as government expenditure nor as government debt;
- according to the decision of DG Competition (C(2011) 2262 final) published in July 2011: *“The Austrian authorities also envisage providing State guarantees to counterbalance the effect of valuation losses of the CDS Portfolio. Such guarantees would be granted under the Austrian FinStaG. The total amount of such guarantees and CP back-up lines taken together will at no time exceed EUR 3 billion”*;
- The Republic of Austria agreed also to transform, starting from 2009 and up to the end of year 2013, part of the guarantee fees received from KA Finanz AG (up to 60 million euro in 2009 and 75 million euro for each of the following years) into capital injections to preserve the required minimum equity ratio. Those capital injections have been also recorded as capital transfers in national accounts;
- at the end of 2011, KA Finanz AG was included in the list of monetary financial institutions for statistical purposes as defined by the ECB and, as such, according to ESA95 para 2.49, was classified in national accounts and for the needs of EDP statistics into the sector of financial corporations. MGDD IV 5.2.2, para 13, stipulates that borderline cases of entities with the fundamental features of defeasance structures, being on the list of Monetary Financial Institutions, will be analysed by Eurostat in close cooperation with the ECB, the national statistical institutes and the central banks, without prejudice to ESA95 para 2.41 and 2.49.

The Capital injection ('Gesellschafterzuschuss'):

Considering that the capital injection is not undertaken with the perspective of obtaining a sufficient rate of return and since, moreover:

- it is intended to compensate losses incurred by KA Finanz AG in the past;
- no new shares will be issued in the context of the capital injection;

the amount injected should be recorded in its entirety as a capital transfer expenditure (D9 in ESA95). As far as the time of recording is concerned, as the exact amount of capital injection was not yet known on 31 December 2011 (only an upper limit was set) the exact government liability resulting from this injection had not yet been established at that date. According to rules, a government expenditure is to be recorded only after the exact amount of the capital injection is known with certainty, i.e., according to Eurostat's understanding, in this case, in 2012.

The guarantee

By providing the guarantee, according to the legal agreement, the Republic of Austria aimed exclusively at bringing KA Finanz AG into a position to maintain the assets involved at their nominal value and to avoid imputing provisions and taking further measures.

All the assets for which the government guarantee applies appear to fulfil the definition of problematic assets according to MGDD IV 5.1.4, they are in the bank's balance sheet in excess of their long-term market or fair value and losses for the future are therefore expected. It is expected that, on average, the assets guaranteed may be written-down by an amount equal to 46.5% of their nominal value.

For some of the assets guaranteed the maturity had already expired at the moment in which the guarantee was granted, so that there was certainty about the actual losses realized on the assets for KA Finanz AG. That seems to be the case for the assets listed in the guarantee contract

Considering that the assets are covered by the guarantee granted by government in addition to a capital injection to cover the expected losses (as mentioned above), it seems certain that KA Finanz AG would not be in a position to cover such losses through its own resources.

It appears that, had the assets not been guaranteed by the government, the capital injection undertaken by the government would have to be higher in order to preserve the required equity ratio of the bank. Both operations should be then recorded in a similar way, considering that their main economic purpose is the same.

The guarantee of government, which extends for the whole period of the maturity of the assets, is to be considered in fact as a guarantee on the losses on the assets, given the link between their existence, their status (non-performing), the value of these assets and the government liability in respect to them, although this is limited up to a ceiling set and will be determined by the expected losses estimated on the basis of provisions undertaken..

It is in fact up to KA Finanz AG to decide when the guarantee will be called, in order to, as specified in the contract, avoid the otherwise necessary risk provisions. This allows KA Finanz AG not to bear losses on the assets, in case these assets are of the bad quality.

In line with MGDD IV 5.2.4 (para 17) the general principles on guarantees' recording must also apply to the guarantees on losses on problematic assets, as defined in MGDD chapter VII.4. A technical example of recording is presented in section VII.4.3.5.3 of the MGDD. The guarantee remains a contingent liability unless it is called or it may be judged with certainty that it will be called for a precise amount. This will then be the time when a respective increase in government expenditure will have to be recorded.

According to Eurostat knowledge, the guarantee has not yet been called by KA Finanz AG. In addition, Eurostat understands that "*prior to the introduction of the collective action clauses (CACs) on 23 February 2012, KF had intended not to participate in the PSI*"¹, so that there was no certainty about the losses to be incurred on the Greek debt covered by the guarantee at the end of 2011. Therefore, certainty on government liability for losses to be realised on those assets was reached only after the economic triggering event took place, i.e. the activation, in the context of private sector involvement programme (PSI), of the collective action clauses by Greece (9 March 2012). Only after this event took place, a reliable estimation of the losses became available.

This means that a capital transfer government expenditure for the whole amount of losses to be incurred up to the ceiling set in the guarantee contract, must be recorded in the year 2012. Simultaneously, a liability of government (other accounts payable, F79 in ESA 95) should be imputed for the same amount and in the same reference period. Nevertheless, in case the nature of the liability would have the features of a loan (e.g. long maturity, level of interest rate), this should

¹ http://www.kafinanz.at/uploads/PA_Griechenland_KF_en_605_EN.pdf

be rather classified as a loan (F4 in ESA95), in national accounts, thus increasing also government debt.

Conclusion

The Capital injection

As regards the capital injection, Eurostat agrees with the Austrian Statistical Authorities that the transaction should be recorded for its full amount as a capital transfer. Nevertheless, this transaction should be recorded in national accounts at the time when the exact amount is known, i.e. in the year 2012.

The guarantee

Taking into account that:

- the economic purpose of the capital injection and the guarantee is basically the same, and that:
- the guarantee will be called, as it covers losses on assets that have been in some cases already realized,

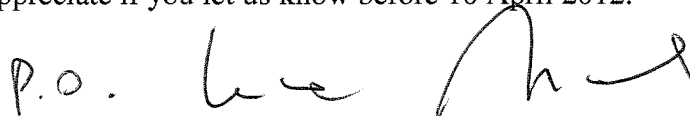
Eurostat considers that a capital transfer expenditure must be recorded in respect to the guarantee and that it should be recorded in the same reference period as the capital injection, i.e. in the year 2012, for the whole amount of losses to be incurred up to the ceiling set in the guarantee contract.

Procedure

This preliminary view of Eurostat is based on the information provided by the country authorities and the official press release of the KA Finanz AG (9.03.2012). 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 adopt 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 is therefore publishing all official methodological advice (ex-ante and ex-post) given to Member States on the Eurostat website. In case you have objections concerning this specific case, we would appreciate if you let us know before 10 April 2012.

Yours sincerely,



On behalf of
the Director
François Lequiller
Director