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Directorate D Government Finance Statistics (GFS) and quality

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Subject: Follow up of the EDP dialogue visit to Ireland at November 2014 - The classification of the Strategic Banking Corporation of Ireland

Dear Ms Banim,

During the EDP dialogue visit to Ireland in November 2014, the classification issue of the Strategic Banking Corporation of Ireland was discussed and because of the complex nature of the issue it was decided that: "*Eurostat and the CSO will continue to discuss the classification of the Strategic Banking Corporation of Ireland (SBCI) with the intention of reaching a decision by March 2015 and the CSO will provide all governing legal acts of SBCI to Eurostat when available. Deadline: end March 2015*"

Since the EDP dialogue visit, the CSO has provided to Eurostat an updated note on the SBCI, the Strategic Banking Corporation of Ireland Act 2014, Articles of association of the SBCI and the Memorandum of association of the SBCI. Based on these documents, Eurostat has studied the issue and made its analysis on the classification of the SBCI.

The classification of the Strategic Banking Corporation of Ireland

Description of the case

The SBCI has been set up in 2014 to source low cost long-term finance from multilateral finance providers and to lend these funds to qualifying financial intermediaries, who will lend directly to Irish small and medium enterprises. The company is owned 100% by the Minister for Finance and it has been set up as en entity with its own Board of Directors. The equity capital of the company is provided by the Minister with a paid-up element of € 10 million, supported by a further € 240 million of callable capital.

The debt capital of the company will be constituted from the following sources: KfW will provide a global loan to the SBCI amounting to €150 million, with the possibility that this could be repeated in a later year as agreed with KfW and the German Finance Ministry, following a review at the end of the first year of the facility. The NPRF will also provide a convertible loan of €240 million following an instruction of the Minister for Finance.

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The EIB has indicated that it will match the funding amounts (circa €400 million) that are to be provided by the other funders. As part of the financing proposal, the Minister for Finance will provide a State Guarantee to the EIB and KfW loans.

In the updated note, the CSO concludes that SBCI is to be classified as a public financial corporation.

Methodological analysis and clarification by Eurostat

After the examination of the documents provided by the CSO, Eurostat has reached the following views:

Applicable accounting rules

The following accounting rules are relevant for the analysis.

- ESA 2010
- The Eurostat Manual on Government Deficit and Debt (MGDD), Implementation of ESA 2010, 2014 edition, Part I Delimitation of the general government sector, and especially Chapter I.6 Specific public entities; Entities having features of captive financial institutions

Analysis

The MGDD part I.6 Specific public entities; Entities having features of captive financial institutions reads: "*One of the most important features is that the entity carries out its activity in the framework of a limited range of activities and in narrow conditions which are mainly designed, significantly influenced, closely monitored and supervised by the parent unit. Although the unit has nevertheless a certain degree of independence in the daily management, it is however aiming at objectives for its controlling unit and is imposed some specific restrictions and constraints.*"

From the documents provided the unit seems to be controlled by the government and from the articles of association of SBCI it can be read from paragraph 15 "Directors" that Directors shall be nominated by the Minister and appointed by the Board. The Board shall have the power to appoint only Directors nominated by the Minister and the power to remove any Director shall reside exclusively with the Minister. The government owns 100% of the shares and has nominating powers relating to Directors so it is to be concluded that the general government is controlling the SBCI.

MGDD also reads: "*Government controlled entity with the characteristics of a captive financial institution may be for instance a public unit which have been entrusted by government to carry out activities in the context of public policies, generally limited to some precise tasks related to them, such as granting loans under more favourable conditions than the markets, or investing in some specific units or sectors (as a leverage tool). Examples of such policies are economic development, regional policy, new technology, climate change mitigation and adaptation, social integration, access to real estate ownership, access to tertiary education, etc. As mentioned above, the government controlled unit would be obliged to conduct its interventions within a narrow framework defined by government, even if* *government would not necessarily have to formally approve/determine every single allocation of assets to every single beneficiary, which however may be frequently the case for operations of a significant size*"

From the description of the functions of the SBCI they seem to be quite limited in nature and devoted to be carrying out public policy activities relating mainly to the provision of loans to SMEs via financial institutions. This proves that government can be considered as controlling the assets of SBCI.

At MGDD paragraph 37 of the chapter I.6.2 it said: "*Government may also provide an explicit guarantee on financial instruments issued by the entity, which will allow the entity to get funds at better conditions (normally benefiting from the rating of its guarantor) or even to have an access to funds market. This would be assimilated to the direct provision of funds if the guarantee would cover a majority of the non-government borrowing of the entity, would be unconditional and might be activated by creditors "at first demand". De facto, the unit would not be placing itself at risk and the cost of borrowing would not reflect the level of risk of the unit which, due to the influence of government, would have only limited profits, if any. In such cases the unit should be classified in the general government sector*."

For the foreseeable future, SBCI will borrow either with a full guarantee from government (in the case of the KfW and EIB) or from a government unit (namely NPFR) and this implies that unit would not place itself at risk and that government controls the liabilities of SBCI. Moreover, in case loans would not be repaid it would not be the commercial banks which would incur losses but government, via the SBCI.

Conclusion

On the basis of the available information of the case, Eurostat analysis leads to a conclusion that the SBCI should be classified into the general government sector from the moment it was founded in 2014 because it currently fulfils the conditions described for entities having the features of captive financial institutions as described in the MGDD 2014 edition.

Yours sincerely,

(e-Signed)

Eduardo Barredo Capelot
Director