



EUROPEAN COMMISSION
EUROSTAT

Directorate D Government Finance Statistics (GFS) and quality

Luxembourg
ESTAT/D1/EBC/LA/SF/ms ARES(2016)

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Subject: Consultation of the statistical classification of Banco Financiero y de Ahorros (BFA)

Ref.: Your letter of 29 February 2016

Dear Mr Cristóbal,

Following your letter of 29 February 2016, Eurostat would like to provide you with its opinion of the sector classification of the *Banco Financiero y de Ahorros (renamed to Banco Financiero y de Ahorros Tenedora de Acciones* from 2015 onwards) in the light of ESA 2010.

The accounting issue

The issue for which an opinion is being sought is a determination of the correct ESA 2010 accounting treatment of the sector classification of the *Banco Financiero y de Ahorros (Banco Financiero y de Ahorros Tenedora de Acciones* from 2015 onwards).

Documentation provided

- Background document on BFA
- Statute of BFA
- Balance sheet and profit and loss accounts of BFA for year 2015

Description of the case

The Banco Financiero y de Ahorros (BFA) was created in December 2010 in the context of the restructuring of the Spanish financial system. BFA was the result of the merge of seven

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savings banks. At that time, BFA was wholly-owned by the seven founding saving banks (which were private financial institutions). At the time it was created, BFA issued convertible preference shares for an amount of 4.5 billion euro, which were entirely subscribed by the Fund for Orderly Bank Restructuring (FROB)^{1 2}. 99% of the assets and liabilities of the seven saving banks were transferred to BFA, which started its activity in January 2011 and operated with a banking licence.

In February 2011, the Royal Decree Law 2/2011 for the reinforcement of financial system, obliging banks to create a special reserve, in the form of provisions to face possible future problems, entered into force. In order to fulfil the new capital requirements, it was decided to offer shares to the public in an IPO³. For this purpose, BFA was split into two entities.

In 2011, a new subsidiary, Bankia, fully owned by BFA, was created. According to the 2011 annual report, BFA transferred to Bankia around 85% of the original assets and liabilities of BFA (all banking business, the participations associated to the financial business and most of the remaining assets and liabilities that BFA had received from the saving banks). On the asset side, BFA remained with impaired assets related to real estate (land and related non-performing loans⁴), the shares of Bankia and participations in other corporations. On the liability side, BFA kept the preference shares subscribed by the FROB and some financial instruments.

The IPO of Bankia took place in June 2011. Private investors bought 48% of the shares and BFA retained 52% ownership.

In May 2012, BFA requested the conversion of the preference shares held by the FROB. Subsequently, in June 2012, the FROB converted all of its convertible preference shares into ordinary equity of BFA⁵. As a result of this conversion, the FROB became the sole shareholder of BFA.

In December 2012, in the context of the recapitalisation of the Spanish banking system, the Spanish government agreed with the European Commission on the BFA-Bankia group's restructuring plan, which included the recapitalisation plan of the group to comply with the Royal Decree 18/2012 of 11 May on the reorganisation and sale of real estate assets of the financial sector and with the Royal Decree-Law 24/2012 of 31 August on restructuring and resolution of credit institutions.

In December 2012, the FROB carried out a capital injection into BFA-Bankia Group amounting to 18 billion euro, out of which 14.5 billion euro was recorded in national accounts as a capital transfer with an impact on the government deficit of 2012.

¹ Classified in the general government sector (S.13)

² At that time, the subscription of preference shares by the FROB was recorded as a financial transaction with no impact on government deficit.

³ Initial Public Offering

⁴ The non-performing assets of BFA (and Bankia) were subsequently transferred to Sareb in 2012 in exchange of bonds issued by the latter.

⁵ At that time, 4.5 billion euro was recorded in national accounts as a capital transfer with the impact on the government deficit.

According to the restructuring plan, the BFA has only a limited lifetime and should cease to exist by December 2017.

In line with this restructuring plan, the BFA had to adopt one of the following measures by the end of December 2013:

- To be merged into a single parent company;
- To be converted into a Holding company without a banking license.

In December 2013, the Board of Directors of BFA agreed to choose the second option. However, the formal request to withdraw their banking licence was addressed to the Bank of Spain only ten months later, i.e. in October 2014.

In December 2014, the Bank of Spain approved the withdrawal of the banking licence from BFA. Therefore, as of 2 January 2015, BFA officially became a holding company, owner of the shares in Bankia and changed its name accordingly to BFA, *Sociedad Tenedora de Acciones*.

Since its creation in 2011 and up to December 2014, BFA had a banking license.

Methodological analysis and clarification by Eurostat

Applicable accounting rules

- ESA 2010, Chapter 2, units and groupings of units;
- Paragraphs 2.57 – 2.78 on Financial intermediation of the ESA 2010;
- ESA 2010, chapter 20, paragraphs 20.35 – 20.37 on public head offices;
- Guidance provided by the Manual on Government Deficit and Debt (MGDD), implementation of ESA 2010, 2014 edition, in part I.6, ‘Specific public entities on Head offices and holding companies’

Availability of national accounting analysis

The Spanish Technical Committee of national accounts, composed of the National Statistical Institute (INE), the Bank of Spain and the Audit office (IGAE), is of the opinion that the *Banco Financiero y de Ahorro* (BFA) was correctly classified in in *Financial corporations* sector (S.12) in the years 2011 – 2014 while they express doubts on how the new *Banco Financiero y de Ahorros Tenedora de Acciones* (BFA) should be classified from 2015 onwards. No opinion on this latter point was provided in the letter submitted by the Spanish Statistical Authorities, as they considered that the rules are too general in order to decide on the proper sector classification of the newly created unit.

Analysis

First of all, Eurostat would like to stress that the sector classification of the *Banco Financiero y de Ahorro* (BFA) has never been discussed with Eurostat up to now and that Eurostat has never agreed to the current sector classification of this unit in the light of ESA 2010. Eurostat is surprised that the issue of the sector classification of this unit has not been raised by the

Spanish statistical authorities in the context of the introduction of ESA 2010, although in September 2014 Eurostat explicitly enquired all Member States about the classification of all public head offices and public holdings.

In addition, Eurostat explicitly asked the Spanish statistical authorities during the July 2015 EDP dialogue visit whether all entities which could possibly be considered as holding companies had been analysed in the light of ESA 2010. The Spanish statistical authorities explained "*that all holding companies were analysed on a case by case basis already before the implementation of the ESA 2010. There is only one public holding (Sociedad Estatal de Participaciones Industriales - SEPI) in the central government level, which is classified in the non-financial corporations sector (S.11), whereas all public holdings in the Autonomous Communities were classified in the general government already.*"

Eurostat regrets to be informed only on 29 February 2016 that BFA was legally converted in the Holding Company already in January 2015, in particular as the sector re-classification may have impacted the ESA 2015 quarterly government accounts, already transmitted to Eurostat⁶.

On the substance, Eurostat has carefully analysed the information provided by the Spanish statistical authorities as well as publicly available annual reports of BFA from 2011 to 2014. Particular attention was devoted to the changes of ownership of BFA in 2012 and the transformation of BFA in a Holding company in 2015.

In 2011, BFA was not was not publicly controlled and, thus, Eurostat does not question the sector classification of this unit in 2011 in the *Financial corporations* sector (S.12). However, in June 2012, government became the sole shareholder (and thus the controlling entity) of BFA through FROB. The sector classification of this unit in the light of ESA 2010 is analysed in detailed by Eurostat as follows.

The analysis of the BFA annual accounts 2012-2014 showed that BFA did not receive any new deposits from clients from 2012 onwards. In fact, the total existent stock of client deposits in 2012 and 2013 (rapidly falling from 1.5 billion euro to 3 million euro respectively) seem to concern so called *legacy deposits* from the seven saving banks, which were subsequently reduced to zero in 2014. The only new deposits received by BFA from 2012 are from the Spanish Central Bank (in 2012) and from other credit institutions (in 2013 and 2014).

This indicates that although BFA had a banking license, it had not actively sought to develop the deposit taking activity.

ESA 2010 paragraph 2.75 defines that, '*the deposit-taking corporations except the central bank subsector (S.122) includes all financial corporations and quasi-corporations, except those classified in the central bank and in the MMF subsectors, which are principally engaged in financial intermediation and whose business is to receive deposits and/or close substitutes for deposits from institutional units, hence not only from MFIs, and, for their own account, to grant loans and/or to make investments in securities*'.

⁶ In this context, the reasons of the above answers provided by the Spanish statistical authorities in July 2015 should be clarified.

In this context, Eurostat's opinion is that BFA cannot be considered a *deposit-taking corporation*, as neither deposits nor close substitutes for deposits have been received from the public (i.e. institutional units different from MFIs) from 2012 onwards.

Furthermore, from the analysis of the BFA annual accounts it seems that BFA did not grant any new loans in the period 2012-2014. This is in line with the fact that the total BFA's banking business was transferred to Bankia in 2011, with some exceptions, as for instance, impaired real estate loans, the majority of which were subsequently transferred to Sareb in the course of 2012. In this respect, it seems that BFA's main activity, from the end of 2012 onwards, was simply to hold the shares of Bankia in addition to government securities and bonds issued by Sareb.

As defined by the ESA 2010 paragraph 2.57, *'The financial intermediation process channels funds between third parties with a surplus and those with a lack of funds. A financial intermediary does not only act as an agent for other institutional units, but places itself at risk by acquiring financial assets and incurring liabilities on its own account.'* Paragraph 2.56 describe intermediation as a "process" where *"assets and liabilities ...are transformed or repackaged in relation to, for instance, maturity, scale, risk, etc."*

On the basis of the above considerations, Eurostat believes that the BFA cannot be considered a financial intermediary because neither undertaking transformation or repackaging activities nor placing itself at risk.

When it was created, BFA had more than 27.000 employees. In 2011, most employees were transferred to the subsidiary Bankia and BFA remained with around 32 employees. However, it should be noted that the number of employees fell down to only one person in years 2012-2015.

ESA 2010, Chapter 2, units and groupings of units on Head offices and holding companies defines in paragraph 2.14 (a) that, *'A head office is a unit that exercises managerial control over its subsidiaries. Head offices are allocated to the dominant non-financial corporations sector of their subsidiaries, unless all or most of their subsidiaries are financial corporations, in which case they are treated as financial auxiliaries (S.126) in the financial corporations sector. ... This class includes the overseeing and managing of other units of the company or enterprise; undertaking strategic or organisational planning and decision-making role of the company or enterprise; exercising operational control and managing the day-to-day operation of the related units.'*

This precondition of ESA 2010 is clearly not fulfilled, as BFA cannot be considered to be conducting head office services, with only one employee. Accordingly, BFA is to be considered only as a "shell". As it does not perform management and effective direction tasks over the subsidiaries, i.e. Bankia, it cannot be consolidated with the latter on this ground but should rather be seen as a *'kind of accounting tool'*. As a result, BFA should be seen as a holding company controlled by government.

ESA 2010 paragraph 2.14 (b) states that, *'A holding company that holds the assets of subsidiary corporations but does not undertake any management activities is a captive financial institution (S.127) and classified as a financial corporation'*.

Holding companies of this class do not provide any service to the businesses in which the equity is held, i.e. they do not administer or manage other units of the group, and only provide

a service to their shareholder (i.e. government). Although according the ESA 2010 paragraph 2.14 (b), a holding company should generally be classified in the financial corporation sector (S.127), however, according to ESA 2010 2.27 and ESA 2010 20.35 (b), this is not applicable to public holdings.

The MGDD, part I.6 paragraph 18 clarifies further the appropriate guidance for public holding companies: *'For transparency and comparability reasons, public holding companies (under the predominant control of government) should be classified in government sector (S.13) and not in the financial corporations sector (S.12), as it would be the case for private holding companies.'*

In addition the MGDD, part I.6 paragraph 46 says that *'From ESA 2010, it must be deduced that a public unit, which holds shares of corporations:*

a) Is classified within general government if:

- it is a "shell" as it does not perform management and effective direction tasks over the subsidiaries but is rather a kind of "accounting tool", as control over the subsidiaries is de facto exerted by government, or it provides some services to its controlling government unit, similarly to an ancillary corporation (for instance collecting data from the group),*

Moreover, it should be remarked that BFA has only a limited period of time (until 2017) and is not a permanent structure. According to the Spanish legislation, Bankia, the main subsidiary is deemed to be fully privatised by 2017. The privatisation process continued in 2014, when BFA sold 7.5% of the shares, and is supposed to be intensified in 2016.

In view of the analysis above, Eurostat concludes that the *Banco Financiero y de Ahorros* (renamed to *Banco Financiero y de Ahorros Tenedora de Acciones* from 2015 onwards), does not comply with the criteria of the financial intermediary, as defined in ESA 2010 and that it is a government controlled holding.

Conclusions

In view of the analysis above, Eurostat concludes that the *Banco Financiero y de Ahorros* (renamed to *Banco Financiero y de Ahorros Tenedora de Acciones* from 2015 onwards) is a government controlled public holding and that it does not comply with the criteria of the financial intermediary, as defined in ESA 2010 and it should be classified in the general government sector (S. 13) in the context of the April 2016 EDP notification.

Eurostat believes that *Banco Financiero y de Ahorros* (renamed to *Banco Financiero y de Ahorros Tenedora de Acciones* from 2015 onwards) should be re-classified in the general government sector from the moment in which assumed the features of the public holding company. As this took place during the course of 2012, and it would be difficult to split assets and liabilities (as well as flows), Eurostat proposes for practical reasons for the re-classification to take place from January 2013 onwards.

Procedure

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 29 March 2016.

Yours sincerely,

Eduardo Barredo Capelot
Director
(*eSigned*)