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Portugal

Subject: Consultation of the statistical recording of the resolution process of BANIF

Ref.: Your notes of 18 and 28 March 2016, Banco de Portugal notes of 22 and 28 March 2016

Dear Mr Oliveira,

Following the above mentioned notes, Eurostat would like to provide you with its opinion on the statistical recording of the Banco Internacional do Funchal, S.A (BANIF) in the context of its resolution process, including the sector classification of the entities concerned.

The accounting issue

The issue for which an opinion is being sought is a determination of the correct ESA 2010 accounting treatment of the BANIF resolution operation.

In December 2015, the Portuguese State, together with the Resolution Fund, carried out a capital injection into BANIF amounting to 2,23 billion EUR. Most assets and liabilities were sold to Banco Santander Totta for 150 million EUR. Problematic assets were transferred to the created “bad bank” – S.A. OITANTE. The remaining assets and liabilities of the group were kept in S.A. BANIF (residual entity).

The accounting issue under discussion is the statistical treatment of the amounts injected into BANIF and the correct sector classification of the entities Oitante and Banif, as well as their subsidiaries.

Documentation provided

INE's notes describing the case and providing the analysis of the statistical recording of the operation and notes of Banco de Portugal on their view of the impact on government debt from the BANIF resolution.

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Description of the case

A capital injection was undertaken in the context of BANIF's resolution, amounting to 2,255 billion EUR, of which 1,766 billion EUR were injected by the State and 489 million EUR by the Resolution Fund.

Most assets and liabilities of the former BANIF group were sold to *S.A. Banco Santander Totta* for € 150 million. The problematic assets held by BANIF were transferred to an entity dedicated to the management of those assets *S.A. OITANTE* (Oitante), which is owned by the Resolution Fund. The assets transferred to Oitante were purchased for a price which is around 33% of the net book value. The Portuguese authorities consider that the acquisition price is below the fair value of those assets. In addition, the assets transferred to Oitante included real estate assets, and those were recorded as gross fixed capital formation impacting the deficit by 179,2 million EUR. As a result of the resolution, Oitante is owning certain entities and their sector classification needed re-evaluation. INE provided their analysis on the entities *Banif Banco de Investimento, SA*, *Banif Imobiliária, SA*, and *Investaçor SGPS*, as well as on some of their subsidiaries.

After the sale and transfer to the bad bank, the remaining assets and liabilities of the group were kept in Banif, S.A. (residual entity). Concerning the sector classification of the residual BANIF and the recording of the corresponding debt there is no common agreement among the Portuguese statistical authorities and Eurostat's opinion is being sought.

Methodological analysis and clarification by Eurostat

Applicable accounting rules

- ESA 2010: provisions for capital injections– paragraphs 20.197–20.203; paragraphs 2.57 – 2.78 on financial intermediation; classification of entities – paragraphs 20.46 and 20.248
- MGDD chapter III.2, Capital injections into public corporations; chapter IV.5 Financial defeasance;
- Eurostat Guidance note of 2012, "*The impact of bank recapitalisations on government finance*", updated in 2013 by Eurostat Decision on the "*Clarification of the criteria for the recording of government capital injections into banks*".

Availability of national accounting analysis

The statistical analysis of INE considers that capital injection into BANIF made by government in December 2015 as a part of resolution process is to be treated in national accounts as a capital transfer (D.9) for its full amount. Oitante purchased the impaired assets of BANIF by issuing bonds. The bond issuance was guaranteed by the Resolution Fund. INE considers that the price paid by Oitante for the BANIF problematic assets is to be seen as a fair value of the assets, as it reflected only 33% of the book value. However, the transferred real estate assets will be recorded as gross fixed capital formation impacting the deficit by 179,2 million EUR.

As for the sector classification of the entities owned by Oitante, INE has conducted the analysis and applied the so called 50% test. The conclusion is that the *Banif Banco de Investimento SA* is a fully operational investment bank, keeping control on the decision making process, and as such should be classified in the sector S.12. As regards the

subsidiaries of *Banif Banco de Investimento SA*, INE concluded, that as these companies are considered institutional units and are actively involved in asset management (pension funds, real estate, risk capital) their sector classification should remain in S.12.

As regards the sector classification of *Investaçor SGPS*, INE concluded that the unit is fulfilling the conditions to be classified as a head office, as it manages the group and provides services to the subsidiaries. The subsidiaries fulfil the so called market /non-market test and are to be considered as market public producers. The group is classified in the sector S.11.

On the sector classification of *Banif Imobiliária, SA*, INE concluded that the entity does not fulfil the market /non-market test and should be classified inside the general government. Two companies of the *Banif Imobiliária* group: *WIL – Projectos Turisticos* and *Gestaquipark* will also be reclassified inside the general government: WIL for failing the market /non-market test and Gestaquipark for not satisfying the definition of an institutional unit, and therefore it has to be treated as an integral part of the parent company.

No agreement on the sector classification of the residual BANIF was reached by INE and BdP. INE considers BANIF as a public defeasance structure. Following the BdP decision, the entity is not allowed to take new deposits or to grant loans, and it cannot be seen as a financial intermediary and should be classified inside the general government.

BdP is of the opinion that the fact that BANIF is still included on the ECB list of monetary financial institutions and has a credit institution banking licence is a decisive argument to classify the unit in the sector S.122.

Analysis

Eurostat has carefully analysed the information provided by the Portuguese statistical authorities as well as the publicly available information.

Capital injection

Eurostat agrees that the recapitalisation of BANIF undertaken by government in the resolution process is to be treated in national accounts as a capital transfer, impacting the government B.9 for its full amount in the year 2015. It is obvious that this capital injection was undertaken as a part of resolution, and with the aim to make further sale possible. Government was acting alone, without any private investor and there was no expectation on any market rate of return on the amount injected.

Transfer of bad assets

The MGDD part IV.5.2.3, paragraph 16 foresees that, in case of transfer of assets for an amount higher than their market value, the difference should be imputed as a capital transfer. Eurostat takes note that Oitante purchased the impaired assets from BANIF at a price amounting to 33% of the book value, and that Portuguese statistical authorities consider it as a market value.

Sector classification of Oitante

Eurostat agrees with INE that Oitante is to be considered as a defeasance structure, as it fully meets the definition as defined in the ESA2010 paragraph 20.46 and it clearly represents the case of the MGDD part IV.5.2, paragraph 10 (1): “*a public body created by government with the clear task to hold problematic assets, frequently until their complete liquidation, and to directly assume losses that cannot be borne by “normal” commercial*

entities.” Oitante is fully owned by the Resolution fund, it is not acting as a private investor and in fact is acting on behalf of government. Although Oitante has borrowed resources to finance the impaired assets, it is not placing itself at risk, and the Resolution fund has guaranteed the bonds. Therefore the correct sector classification is inside the general government.

Sector classification of residual BANIF

Eurostat takes note that there is no common agreement among between INE and BdP on the sector classification of BANIF in Portuguese national accounts.

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’.*

Eurostat takes note that, as indicated in INE’s analysis, and described in the supporting documents, a decision of BdP prohibited BANIF from taking new deposits and granting new loans. Therefore, de facto, the main activity of the residual BANIF, since its activation in December 2015, is not financial intermediation – neither deposits nor close substitutes for deposits have been received from the public, and BANIF did not grant any new loans.

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, and in line with INE's analysis, Eurostat believes that the BANIF cannot be considered a financial intermediary because it is neither undertaking transformation or repackaging activities nor placing itself at risk.

Eurostat believes that the BANIF case is mostly defined in the MGDD part IV.5.2, paragraph 10 (2) b): *“the financial institution transfers, under various procedures, its “commercial profitable activity”*”. As a consequence the unit is left with the management of some problematic assets, which therefore become its main activity, and this is achieved with a strong support of government and under its control (government being generally the main shareholder, directly or indirectly through other public bodies).

Moreover, it should be noted that BANIF has only a limited period of time and is not a permanent structure. The MGDD Part IV.5.2. paragraph 9 foresees that *“a financial defeasance structure is an institutional unit, which has substantial problematic assets, whose principal activity is the resolution of these assets generally over an extended period of time and not the provision of financial intermediation services. Such institutional unit is not a financial intermediary as defined in ESA2010”*.

ESA2010 paragraph 20.46 defines the defeasance structure as a restructuring agency dealing with impaired assets, which *“shall be classified according to degree of risk it assumes,*

considering financial support of the government”. (...) “if a defeasance structure does not place itself at risk, it is classified to the general government”.

In view of the analysis above, Eurostat agrees with the view of INE, and concludes that the BANIF does not comply with the criteria of the financial intermediary, as defined in ESA 2010 and that it is a government owned defeasance structure, with assets which must be wound up in a short period of time. Therefore, as such, it should be classified inside the general government sector.

The reclassification of BANIF inside the general government means, as for all other existing entities part of government, inclusion of the entities assets and liabilities into the balance sheet of government. Therefore, the liabilities that are part of the Maastricht debt for the purposes of the Protocol on the excessive deficit procedure, are to be included in the government debt.

Conclusions

Considering the above analysis, Eurostat considers that the recapitalisation of BANIF undertaken by government in the context of a resolution process, is to be treated in national accounts as a capital transfer (D.9), impacting the government B.9 for its full amount (2,255 billion EUR) in the year 2015. The Public defeasance structures Oitante and BANIF, including their assets and liabilities, are to be classified inside the general government.

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 11 April 2016.

Yours sincerely,

(e-Signed)

Eduardo Barredo Capelot
Director