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Directorate D: Government Finance Statistics (GFS) and quality

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**Subject: Sector Classification of Investsud**

Ref.: Your letter T/ICN/2016-004245 of 20 July 2016  
Our letter Ares (2016)2897402 of 18 May 2016  
Your letter T/ICN/2016/001123 of 25 February 2016  
Our letter Ares(2015)3306092 of 7 August 2015  
Our letter Ares(2015)2667665 of 25 June 2015  
Your letter T/ICN/2015/001964 of 20 March 2015  
Our letter Ares(2015)1171689 of 17 March 2015  
Your letter T/ICN/2015/000531 of 30 January 2015

Dear Mr Delporte,

Thank you for your letter dated 20 July 2016 providing the additional documentation requested by Eurostat. After having closely examined the dossier and the documentation transmitted, Eurostat is now in a position to express its view on the sector classification of Investsud.

## **1. THE ACCOUNTING ISSUE FOR WHICH A CLARIFICATION IS REQUESTED**

The issue to be analysed is the sector classification of Investsud and its affiliates. Investsud is an investment company in Wallonia, specialised in risk capital, co-sponsored by a private holding (Financière du Sud-Est) and the Region of Wallonia, operating in Liège, Namur and Luxembourg.

### *a) Summary of previous views and exchanges*

After a close examination of the specific case of Investsud, the NAI reclassified Investsud, in September 2013 and under ESA 95 rules, in the general government sector (S.1312) together with other eight similar units acting in Wallonia, the so-called "Nine invests Walloons".

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In August 2014, the management of Investsud contested the decision of the NAI to classify the unit in the government sector. Since then, exchanges have taken place between Investsud and the NAI.

Based on the additional information received from Investsud, the NAI, in its letter dated 30 January 2015, changed its analysis and proposed to classify Investsud in the financial corporations sector (S.12), under ESA2010 rules, and to reroute in the accounts of the Region of Wallonia the assets funded by the "*droits de tirage*" provided by the regional government on the basis of a bilateral agreement with Investsud. The following were the criteria forwarded by NAI to support such a change in its view of the issue:

- Even if, with 26% of the shares, the Region of Wallonia has some veto rights (e.g. to change the statute of Investsud, to modify its purpose or to decide on its dividend policy), this criterion is not sufficient to decide on the sector classification of a unit;
- The Region of Wallonia does not control Investsud via control of its Board of Directors;
- In case its investments do not respect the conditions set in the bilateral agreement with the Region of Wallonia, Investsud may still decide to invest on the basis of its own funds.

The NAI has furthermore requested Eurostat's opinion on this issue. Following some exchanges of letters and, also, recent additional information concerning the enlargement of Investsud's activities and financing, Eurostat is in a position to provide its opinion on this case.

#### *b) Description of the case*

##### General features of the "Nine invests"

The "Nine invests" are local investment companies created at the specific initiative of government, whose purpose is to implement policies of regional development and of reconversion of specific areas, by providing financing under various forms (subordinated loans, guaranteed loans, equity injections, etc.).

The shares of these units are owned by the Region of Wallonia on the one hand and by private investors on the other hand. The percentage owned by the regional government varies between units. Apart from the capital, which is provided in proportion to the number of shares owned, the financing of these units is mostly provided by the Region of Wallonia on the basis of specific bilateral agreements with each unit, according to which the Region of Wallonia provides funds, remunerated generally at very low rates.

The Walloon government can also assign specific missions to the "Nine invests", which have specialised subsidiaries for different activities. For instance, in the framework of the so-called Plan Marshall, an investment strategy for the "Nine Invests" in favour of spin-offs, spin-outs and start-ups was defined by the Walloon government and, accordingly, some of the invests created specific affiliates for this purpose.

On behalf of the regional government, Sowalfin (classified in the State government sector) supervises the activity of the "Nine invests", verifies the fulfilment of the criteria set by the region for the granting of financing to SMEs, decides whether to grant derogations in case of non-fulfilment of the aforementioned criteria and ensures the coordination among the "Nine invests" on the one hand and between the "Nine invests" and the financing activities undertaken by the Sowalfin on the other hand.

## Investsud's characteristics and specificity

### *Origin*

The unit was created in 1983 at the initiative of government with the aim to develop industrial and commercial activities in Liège, Namur and Luxembourg. Investsud provides capital risk financing to small and medium enterprises (SMEs) in the framework of the restructuring of the south-east of Belgium.

Concerning the shareholder structure, at inception, 50% of the shares of Investsud were held by the Federal government, via the Société Nationale d'Investissement (SNI), and the remaining 50% were held by private shareholders. From inception, all ad-hoc financing ("*droits de tirage*") was provided by the Federal Government on the basis of an agreement with Investsud.

In 1993, the Federal Government transferred its claim ("*droits de tirage*") towards Investsud to the Region of Wallonia and the SNI was liquidated, but no agreement was reached between the Federal government and the Region of Wallonia to purchase the shares held by the Federal government. Eventually, the private shareholders purchased the stake of the Federal government in the entity and as a result Investsud was 100% held by private shareholders temporarily, between 1993 and 1997.

### *Current situation*

In 1997, the regional government eventually acquired shares. Since 1997, 26% of the shares are owned by the Region of Wallonia (via Sowalfin, a public enterprise classified in the regional government sector) and 74% of the shares are owned by private investors – via *Financière du Sud-Est*, FSE. FSE is a holding company owned by ten private shareholders (each holding 10% of the shares).

In 1997, when the regional government acquired the shares, a bilateral agreement was also signed between the Region of Wallonia and Investsud, defining a new specific framework for the financing of Investsud through the provision of financial advances by the region (the so called "*droits de tirage*"). The agreement defined, as well, a set of criteria that each project undertaken by Investsud should fulfil in order to be financed by the "*droits de tirage*". Such criteria are the following:

- Respect of the corporate purpose: industrial, commercial or activities related to the provision of services aiming at valuing the natural resources of the South-east of Belgium;
- Respect of the geographical limit: provinces of Liège, Namur and Luxembourg;
- Investment in a SME;
- Investment in corporations which are not in distress;
- The beneficiary enterprise should belong to sectors that are eligible to receive investment grants;
- The project needs to be declared viable and profitable by the board of Investsud;
- A minority participation in the capital (limited to 50%).

Until recently, Investsud was financed exclusively by own funds and by the "*droits de tirage*" provided by the regional government on the basis of the bilateral agreement signed in 1997 mentioned above. Since 2015, Investsud is also drawing financing from loans granted by commercial banks (EUR 25 mn). According to its balance sheet, in 2014 the own funds of Investsud were around EUR 16 mn (out of which EUR 6.2 mn was equity capital, 26% owned by the Region of Wallonia) and the "*droits de tirage*" owed to the Region amounted to EUR 22.2 mn.

Investsud seems to be undertaking an activity similar to "private equity", by providing financing to small non-quoted companies. Although the financing provided by Investsud can take different forms according to its statute, it seems that, in practice, most of its interventions take the form of equity injections.

The investments undertaken by Investsud are financed, on the one hand, by the "*droits de tirage*" provided by the Region, if the set of criteria fixed in the bilateral agreement and listed above are met. For each individual dossier, the region needs to provide its explicit agreement. On the other hand, in case of non-conformity with the region's criteria, the investments can however still be financed, but on the own funds of Investsud or via its borrowing. This constitutes the main difference between Investsud and the other eight "invests" existing in Wallonia (for which, in case of non-conformity on a dossier, the investment cannot be undertaken).

It is important to underline the three main features of the "*droits de tirage*" scheme, which are specific financial advances provided by the regional government.

**First**, the remuneration of the "*droits de tirage*" is fixed at 20% of Euribor 1-year, with an overall cap of 1%, which constitutes a very low value (particularly, historically, over the 1997-2008 period).

**Second**, the reimbursement of these financial advances is conditional on the financial results of the unit and is carried out in a very peculiar way (through crediting a Region's account at Investsud). In case Investsud incurs losses, no reimbursement of the financial advance is done in that period. Even in case of profit, the reimbursement of the "*droits de tirage*" is "subordinated" to the distribution of dividends, which must come in the first place. The profit is allocated in strict order as follows:

- First, 5% of the profit must be allocated to the legal reserve;
- Then, a dividend representing 8% of the registered capital must be paid to the shareholders (on the EUR 6.2 mn equity capital, i.e. dividend of EUR 496,000), if possible;
- Subsequently, 75% of the remaining profit must be allocated to a special reserve, 2/3 of which is used to reimburse the financial advances to the Region via a '*compte courant*' not bearing interest. In practice, there is no cash actually repaid to the region, and the related amounts are set aside in an account that – as Eurostat understands it – the regional government cannot freely dispose of. This incapacity for the Region to cash in the "*compte courant*" merely transforms the "*droits de tirage*" financing into a "*compte courant*" financing.
- Finally, the general shareholders assembly decides on the allocation of the remaining surplus: 25% of the profit after dividends, which can be used for constitution of reserves or as deferred profit.

Moreover, the general shareholders meeting can decide by qualified majority (75%, implying a veto right for the Region) to proceed differently and to pay a higher dividend or to increase the reserves, thus lowering the amount of "*droits de tirage*" to be reimbursed<sup>1</sup>.

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<sup>1</sup> At least on two occasions (2006 and 2013), a dividend of 16% (EUR 992,000) rather than 8% has been paid to shareholders, with the consequence that the reimbursement of the "*droits de tirage*" in those years was substantially lower than the 2/3 of the 75% of the profit after the 8% dividend stipulated in the statute. This was decided in the shareholder meeting and the region did not block the decision, accepting to be reimbursed

**Third**, the bilateral agreement also foresees a mechanism to "adjust" or write-off the debt of Investsud towards the Region in certain circumstances, for instance if there are unrecoverable claims in cases of liquidation or bankruptcy of SMEs which have received financing by means of the "*droits de tirage*". This adjustment/write-off was capped to the total loss of Investsud in the same year. This would seem to entail the fact that Investsud and its shareholders do not fully bear the risk for investments undertaken by using "*droits de tirage*" and that, instead, the regional government is bearing part of the risk of the private shareholder equity.

More recently, Investsud has decided to unilaterally renounce to this write-off of claims arrangement. This renouncement may however be more formal than substantial given that, *de facto*, the debt towards the Region of Wallonia is not actually reimbursed (but credited to a dedicated Investsud 'compte courant'), and the only possibility for an actual reimbursement to happen would be through a dissolution decision by the Board of Directors of Investsud, where the Region of Wallonia does not hold the majority of votes.

Concerning the normal shares, aside from the 8% coupon distributed as mentioned above, additional coupons can be distributed, although the region has veto powers.

Furthermore, a specific clause concerning the liquidation of Investsud was included in the statute in 2006 at the request of the region. After repaying outstanding debts and liquidation fees, the accumulated reserves (part of own funds) to be distributed to the shareholders according to their share in the equity, would not be those accumulated until the year of liquidation, but, instead, those existing in the balance sheet as of 31 December 2005. The remainder, i.e. the increase in the accumulated reserves between 2006 and the year of liquidation, is to be fully transferred to the regional government. The Region thus seems to have a privileged position in case of liquidation, as it is entitled to receive the non-distributed profits accumulated from 2006 onwards. This clause was presented as a deferred ex-post remuneration for the financing by "*droits de tirage*" provided by the Region, to partially compensate for the very low rate charged.

Notwithstanding this, it is worth noting that Investsud can only be dissolved following a decision of its General Assembly, such that, in fact, the Region of Wallonia cannot impose the liquidation to Investsud (in order to partly or totally recover its financing in Investsud).

It should also be noted that both FSE (the private shareholder) and the region receive what seems to be a "management fee" of approximately 0.5% of the assets managed (3% of the value of the own funds or 8% of the equity capital), which could also be interpreted as compensation for the absence of board member remuneration.

Concerning governance, Investsud has a board with at least three members appointed by the general shareholder assembly, which decides as well on the number of members in the board. The composition of the board is proportional to the number of shares held by the private shareholders and the Region of Wallonia. The president of the board is appointed among the candidates proposed by the private shareholders. Decisions are taken by simple majority. At present, there are 14 members in the board of Investsud, of which 11 appointed by FSE and 3 appointed by the Region of Wallonia. In addition, the region of Wallonia appoints an observer who attends the meetings of the board without having voting rights.

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for lower amounts and to distribute a higher dividend (the total amount "received" by the region for the reimbursement of "*droits de tirage*" plus the dividend being lower than the amounts originally foreseen in the statute, for instance, around EUR 269,000 were received in 2006 versus EUR 388,000 obtained from the calculations as defined in the statute).

## 2. EUROSTAT'S ANALYSIS

The required analysis should aim at determining whether Investsud is an institutional unit or not, and, if not, determine which would be the parent entity, either the region of Wallonia or FSE.

If Investsud is an institutional unit, the question is then whether it is publicly controlled or not, and whether its activity is market or non-market. It should be noted that the market/non-market criterion receives a specific interpretation when the unit is seemingly engaged in financial activities.

In the circumstances, a specific analysis of the "*droits de tirage*" and of the share instruments is necessary to identify the true nature of the unit and its ESA classification, which in turn will impact on the analysis above, notably in the determination of control.

Determining the control of the entity is the key point in this analysis.

### *a) Institutional unit*

Whether Investsud is an institutional unit or not will not determine the sectorisation of the unit, control and market/non-market analysis being the determining elements of the decision in this case.

On the one hand, Investsud may be considered as meeting the definition of an institutional unit, i.e. as regards the autonomy of decision criteria, to the extent that, although it operates under significant constraints laid out by its statute (and the bilateral agreement with the Region), it seems to have significant autonomy with respect to investment decisions for a non-negligible part of its activity. The next steps would then be to determine control and the market/non-market nature of the entity.

On the other hand, the Region keeps both the control on the investment decisions that it directly funds and most of the risks and rewards on all Investsud assets. On this basis, there would be ground for not recognising the autonomy of decision and for integrating Investsud into the Region, its controlling parent. Alternatively, Investsud may be consolidated with FSE, on the basis that Board members of both entities largely overlap.

### *b) Control*

With respect to control, it should be stressed that the structure, the features and the framework in which this unit operates, are complex and a detailed analysis is therefore required.

### *Preliminary reflexion on who controls Investsud – basic criteria*

Investsud was created at the initiative of government and operates, up to date, in the context of public policy.

By owning 26% of the shares, the regional government has minority blocking rights for key decisions that need a qualified majority, as defined in the legislation for corporations in Belgium, such as changing the statute of the unit, dissolution, liquidation, change of the corporate purpose and increase/reduction of the equity. In addition, the regional government has also a veto right concerning the possibility of the shareholders to increase the dividends paid and/or the reserves, instead of reimbursing the "*droits de tirage*" to the region.

Nevertheless, even if the Region of Wallonia has veto rights in some major decisions, its 26% of capital are not sufficient to enforce some other key decisions, most notably the repayment of the debt towards the Region or the dissolution of Investsud.

Although private shareholders have a majority participation of 74% in the shareholding of Investsud and can take certain decisions, the principle of economic substance over legal form should prevail (as it must be the case in national accounts) and the involvement of government needs to be carefully analysed.

As stated in the MGDD, a unit which is privately-owned in majority can still be part of the public sector in case certain criteria are met (see I.2.3 paragraphs 14).

Furthermore, although the majority of Investsud's directors is not appointed by the Region, this does not prevent Investsud to be potentially public, based on the other criteria of public control, listed in ESA 20.309. While majority appointment of the board by the public sector is sufficient to ensure public control (see ESA 20.310), the reverse need no be true: majority appointment by the private sector may not ensure private sector classification. Other criteria need to be examined, before concluding.

Private control should then be ascertained, notably by the examination of other criteria. Given the complexity of the case and its borderline nature, one significant consideration would be whether FSE consolidates Investsud in its financial statement, or would do so if it had to present consolidated financial statements under IFRS. IFRS's control requires the ability to extract benefits and be exposed to risks (control for a benefit), a condition that needs to be carefully examined in this case.

#### Analysis of the funding instruments and of Investsud's ownership

As concerns the "*droits de tirage*" (held by the Region), the following should be stressed:

- First, as concerns their remuneration, the cost for Investsud, which is close to zero, is very low compared to the average cost of borrowing in the market (particularly when averaged since the creation of Investsud);
- Second, no 'reimbursement' is done by Investsud in case of losses or in case profits are not sufficient. In case of profit, the equity holders are remunerated first (at a rate of 8% of the registered capital) and then, a share of the remaining profit should be used to 'reimburse' the "*droits de tirage*". If the general assembly decides not to reimburse the "*droits de tirage*" on the basis of this clause and, instead, pay a higher dividend to shareholders or put the profits in the accumulated reserves, the Region has a veto right on this. In at least two years, the Region did not use its veto right against proposed exceptional dividends (to avoid the non-reimbursement of the "*droits de tirage*") and, thus, accepted to "be reimbursed at a slower pace";
- Third, and more crucially, the 'reimbursement' is in fact 'nominal' as it takes the form of crediting a region's account in the book of Investsud, which – as Eurostat understands it – cannot be cashed by the Region.

As concerns the shares (76% held by the private entity FSE, and 26% by the Region), the following should be stressed:

- Concerning the dividend policy, a 8% preference dividend to remunerate the equity is fixed in advance in the Statute. Only once this "preferred dividend" is paid, the general assembly can decide in practice (by qualified majority, i.e. with veto right for the Region) on how to allocate the remaining profit;

- In case of liquidation, the Region is entitled to receive all the non-distributed profits (reserves) accumulated from 2006 onwards. This is deemed to constitute an additional remuneration of the "*droits de tirage*", which are poorly remunerated before liquidation. It has been presented as being a way, for the Region, to receive part of the rewards that it should be entitled to receive for providing the funding and taking most of the financing risk.

Overall, the risks, which by definition should be mostly borne by the equity capital, are to a large extent mitigated for shareholders, and in fact are largely borne by the Region. This is directly true for the investments funded by "*droits de tirage*", and is indirectly also the case for the other investments through the way the remuneration and redemption of the "*droits de tirage*" and of the equity capital are organised.

The shareholders have preferred rights in case of profit, as the equity is remunerated at a high rate before reimbursing the "*droits de tirage*". There is no pre-fixed compulsory scheme to reimburse this latter instrument, the reimbursement being conditional not only on the profit, but also on the decision by qualified majority of the shareholders (requiring the agreement of the Region). This would, by itself, already indicate some lack of symmetry as concerns the risks and rewards undertaken by the private shareholders. While shareholders can earn rewards, the amount of risk (i.e. the incurrence of losses) incurred seems to be very limited, if any.

Following the above, the nature of the "*droits de tirage*" seems to be much closer to equity instruments than to debt instruments. In contrast, the shareholder's shares have some features of debt, given that their remuneration is largely pre-fixed, and, crucially, their liquidation value is fully capped. In this manner, the upside is non-existent, and all the over-performance is (potentially) captured by the Region. Overall, Investsud shares resemble hybrid instruments like so-called "cocos", which, though counted as regulatory capital in other administrative contexts (e.g. Basel), are normally recorded in national accounts as debt instruments.

Following this analysis, it should be considered that, in substance, the "*droits de tirage*" are assimilated to a kind of equity and that, on the contrary, the initial equity capital of Investsud is assimilated to hybrid-like instruments, such as "preference shares" with a fixed rate of return set at 8%. On this basis, it would be as if the Region of Wallonia owned the majority of the equity of Investsud.

An analysis of risks and rewards thus points to a borderline case concerning Investsud. Because of the nature of the "*droits de tirage*", close to equity instruments, the capital would be considered to be owned by the Region, even if no specific voting rights (apart from the conditions set in the bilateral agreement) are attached to the "*droits de tirage*". In addition, in case of dissolution of Investsud, the Region would be in a very favourable position. In this sense, the ownership of Investsud is in the hands of the Region.

One way to look at the substance of the Investsud arrangement is government hiring private counsel for a government sponsored capital risk scheme, the private advice being remunerated in the form of a 0.5% fee on asset managed, prorated, and a quasi-assured 8% of equity capital.

#### Other criteria of control

As stated above, Investsud did not borrow in the market until recently and, disregarding the equity, government was, prior 2016, the only provider of funds. In other words, the regional government had control over the liabilities of this unit.



Financing is a significant criteria for establishing control, according to ESA 2.38 (h) and ESA 20.309 (g) ("*If the public sector imposes controls through lending which are tougher than a private sector entity would typically face from a bank, this is an indicator of control*").

This argument alone may be sufficient to indicate public control in the case of Investsud. This notion of control through financing is not only a theoretical consideration, but was also proven in practice. Indeed, as Investsud private partners initially refused to accept a modification in arrangement sought by the Region in 2002 (and accepted by the other 8 entities of the "9 Invests Wallons"), the Region responded by systematically vetoing all projects financed with "*droits de tirage*" from 2002 onwards. This eventually led to the 2006 agreement.

In addition, ESA 20.309 (i) states that "*An entity that is fully or close to fully financed by the public sector is considered to be controlled if the controls on that funding stream are restrictive enough to dictate the general policy in this area*". The fact that most of the invested funding was provided by the Region on the basis of the bilateral agreement, which imposes certain conditions for the investments, shows that the conditions set in ESA 20.309 (i) were fulfilled.

However, since the end of 2015, Investsud is also borrowing on the market, by way of contracting a credit line of EUR 25 million from two commercial banks. After analysing the information provided by NAI, Eurostat concludes that the loans obtained by Investsud are not guaranteed by the Region of Wallonia and that the covenants associated to these loans seem not to include any unusual or non-commercial features.

It should be noted however, that while the amount was drawn down in full in 2015, it was not used to reimburse the region for its "*droits de tirage*". One would notably need to assess whether Investsud has the contractual as well as the practical capacity of using up substantially all the amounts drawn down, without breaking any covenants, including shifting deposits to other banks than the lending banks – that is: the borrowing is not so encumbered by covenants that it would hardly amount to a genuine means of funding.

Finally, ESA 20.309 (f) also suggests that when the sales of an entity are all to government, this is also an indicator of control. It should thus be determined who is the buyer of the services carried out by Investsud.

#### Control of Region's funds in Investsud

An analysis of the characteristics of the "*droits de tirage*" points to a borderline case concerning the control of Investsud's assets funded by the Region of Wallonia. On the one hand, it is clear that, when investing the funds provided by the Region, Investsud acts on a very narrow/specific framework and for each individual dossier Investsud needs an explicit agreement from the Region. This may make Investsud look like a captive of the Region of Wallonia.

Nevertheless, given that the decision to dissolve Investsud can only be taken in its general assembly and that the Region does not hold the majority of the votes, *de facto*, the recovery of the funds invested is not in the hands of the Region. In this sense, and adding to the fact that the Region is not genuinely being reimbursed of the funds it invested in Investsud, it could be argued that, in fact, the Region does not control the funds it invested in Investsud.

As these funds are *de facto* not repaid and their repayment cannot be enforced by the Region (not even through the dissolution of the entity, because it is outside the control of the Region), one interpretation of this situation would be that the funds transferred by the Region to

Investsud have the features of a grant (i.e. a capital transfer). Although the liquidation of value of Investsud may still need to be represented by an equity stake of the Region in Investsud as mentioned above (through revaluations), a capital transfer would be recorded based on the fact that the remuneration on the instrument is very low and the return of asset is outside the Region's hand.

An alternative interpretation is that these funds are still government assets and, because the individual investment decisions are controlled by the Region, Investsud assets financed by these funds may be re-routed to the balance sheet of the Region.

### Summary on control

The following conclusions on control can be drawn from the points underlined above:

- The complexity of the Investsud arrangement is such that the shareholders are *de facto* holding a kind of subordinated debt, while government has ownership in Investsud through "*droits de tirage*", through its 26% capital stake and through its privilege access to all retained earnings since 2006 onwards;
- Government has scope to exercise significant control on the Investsud decision making process regarding assets and liabilities, which may suggest Investsud to be a captive, except for the fact that the Board may go on to acquire assets from its own funds or from borrowing and for the fact that Investsud has borrowed significant amounts from banks since 2015 (assuming the funds levied can be used without restriction);
- Government cannot force the repayments of the "*droits de tirage*": the reimbursements are *de facto* retained within Investsud, and government cannot force the liquidation of Investsud.

As a result, recognising or rejecting public control appears to Eurostat a highly uncertain matter. In such a borderline case, Eurostat considers that private control could be envisaged in case the IFRS financial statements of FSE would consolidate Investsud. Otherwise, Eurostat suggests prudence and presume public control.

If private control is determined, then Eurostat proposes to record a capital transfer at time of drawing down of the "*droits de tirage*" – in recognition of the fact that the investment does not provide sufficient return and that the return of funds is outside the control of government. "*Droits de tirage*" and the Region 'compte courant' at Investsud may nonetheless still be recognised as equity of the Region (through revaluation).

### *c) Investsud activity and market/ non-market nature*

Investsud is a unit seemingly involved in financial activities, operating in the field of specialised finance, in a manner similar to "private equity" or "risk capital" entities, which are normally classified in the sub-sector of 'other financial intermediaries, except insurance corporations and pension funds' (S.125). Investsud manages assets and seems to be placing itself at risk by incurring liabilities on its own account for a significant part of its activity.

At the same time, in the context of the bilateral agreement with the Region of Wallonia, and with the funds ("*droits de tirage*") provided by the latter, Investsud is not carrying a normal commercial activity as a typical private corporation would do. The funds it borrows from the Region of Wallonia are under very advantageous conditions that are not assimilable to borrowing on the market. As for the assets financed with these funds, Investsud operates in a narrow specific framework (SMEs in three provinces, operating in a few sectors, etc.) that cannot be modified without the agreement of the region. From the accounts of the unit and the documentation provided, it can be concluded implicitly that the unit is not investing according to normal market terms (given that borrowing costs are very low, almost zero, and that the

equity is remunerated at 8%, which typically absorbs the entire unit's profit). It is therefore doubtful that it the activity that it carries is market. It may be seen as a captive of the Region (to be classified inside government), at least until 2015.

However, if it was determined that Investsud is not controlled by the Region (see section above), and even though it would be found to have been largely financed through capital transfers, it would necessarily be classified as market by convention – either as a market local KAU of FSE or as a market subsidiary of FSE. This is because no private nonmarket entities are recognised unless they are NPISH. Investsud is clearly not serving households.

Investsud has recently started a new co-financing activity, in which it invests in SMEs jointly with private individuals. This new step may point to the commercial nature of Investsud's investment strategy for the near future.

Following this line of reasoning, on the basis of ESA 20.33, Investsud would be a financial intermediary.

It is recalled that the market/non-market quantitative criterion is not particularly relevant in such entities carrying seemingly financial intermediation. Indeed, Investsud earnings consist of property income, mostly dividends (aside from capital transfers), and holding gains (ESA 20.34), and would fail the 50% test.

At the same time, there is a need to identify who is the buyer of the production of Investsud. When Investsud is considered a local KAU of FSE, this is without difficulty: FSE is the buyer. When Investsud is considered a subsidiary of FSE, the buyer of the services would likely be FSE again.

An alternative option would be to see Investsud as a mere 'money manager', managing a government portfolio. Government would be hiring the expertise in capital risk investment of private partners, which would be remunerated in the form of an arrangement involving the legal features of equity participation rather than a performance based fee contract. This view is also substantiated by the analysis of the nature of the equity, as a number of ad-hoc clauses turns the equity participation into a quasi-fix remuneration contract, at 8% of face value (falling to zero in case of loss), with limited upside for the capital, and significant protection on the downside.

Under this hypothesis, most of Investsud assets and liabilities would be routed through government accounts, and Investsud would be seen as a financial auxiliary (S.126), rather than a financial intermediary. While, under this reading of the situation, the sole client of Investsud is government, which may point to public control according to ESA 20.309 (f), this is only one criteria to envisage. In the specific circumstance of Investsud, Eurostat would see no difficulty to consider Investsud as a private provider of financial auxiliary services to the Region.

#### *d) Summary*

In substance, Investsud should be seen as a unit *de facto* mostly owned and partly financed by government, which operates in the context of public policy on the basis of a specific framework defined by government.

As seen above, government would be hiring the expertise in capital risk investment of private partners, which would be remunerated in the form of an arrangement involving the legal features of equity participation rather than a performance based fee contract. To the limit, this may point at Investsud – stripped of most of its assets and liabilities – to be recognised as a (private) financial auxiliary (S.126).

Furthermore, the Region's powers – most notably for deciding each individual drawdown on "*droits de tirage*" – may point at Investsud being a (public) captive (S.13).

However, the fact that the Region cannot ensure it would be reimbursed for the "*droits de tirage*" suggests an alternative reading favouring private control of a financial intermediary (S.125). This can be accepted, if the IFRS financial statement of FSE does (or would) consolidate Investsud and if the recent amounts borrowed from banks (and actually drawn down) can be actually used for investment or transferred to other banks without limitations.

### **3. CONCLUSION**

In conclusion, considering the above, it is the opinion of Eurostat that the following sector classification options can be envisaged for this complex case of Investsud:

1. Investsud can be seen as a privately controlled financial intermediary (S.125), if the IFRS financial statement of FSE (the private entity holding 74% of Investsud shares) does (or would) consolidate Investsud and if the recent amounts borrowed from banks (and actually drawn down) can be actually used for investment or transferred to other banks without limitations.

In this case, the financing provided by the Region of Wallonia in the form of so-called "*droits de tirage*" would be recorded as capital transfers, in recognition of the fact that the funds provided to Investsud by the Region of Wallonia are historically not reimbursed, and of the fact that the Region cannot impose the dissolution of Investsud in order to enforce at least a partial reimbursement;

2. Alternatively, Investsud may be seen as a private financial auxiliary (S.126) providing services to the Region. This implies that most of its assets and liabilities shall be routed through government (S.1312) accounts.
3. Otherwise, Investsud would be classified in general government (S.1312) as being seen as public controlled and either a captive of government or an entity having non-market activities (with government as sole client).

### **4. PROCEDURE**

This view of Eurostat is based on the information provided by the Belgian 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 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 its website. In case you have objections concerning the publication of this specific case, we would appreciate if you could let us know before 28 February 2017.

Yours sincerely,

*(eSigned)*

Eduardo Barredo Capelot  
Director