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Hungarian Central Statistical Office
Ms Gabriella Vukovich - President
Keleti Károly u. 5-7.
1028 Budapest
HUNGARY

Subject: Statistical classification of the Hungarian Central Bank's foundations and their subsidiaries

**Ref: Ad-hoc EDP visit discussions of 22 September 2016 and 12 September 2017
Bilateral clarifications under the EDP notifications of October 2016, April and October 2017, respectively
Your e-mail dated 2 October 2017
Our letter dated 22 March 2018 (our ref.: ARES(2018)1591095)
Your letter dated 29 March 2018 (your ref.: KSH/1256-2/2018)
Our letter dated 16 April 2018 (our ref.: ARES(2018)2025168)
Your letter dated 24 July 2018 (your ref.: KSH/1528-2/2018)
Your e-mail dated 4 September 2018**

Dear Ms Vukovich,

Thank you for your letter of 24 July 2018 regarding the sector classification of the Hungarian Central Bank's (MNB) foundations and their subsidiaries. Please find below our reply to the various points you raise in your letter and our unchanged conclusion on the basis of the information at our disposal.

The case, in short

As we have written in our previous letters, in line with the relevant provisions of the ESA¹, we regard the foundations, containing their appropriately apportioned subsidiaries, as institutional units. We note that the Hungarian Central Statistical Office (KSH) did not object to this view. Furthermore, as we have explained, we do not share the view of the KSH that the consolidation of the subsidiaries would alter the market/non-market profile of the foundations and the resulting institutional units.

Due to the various arguments we have presented in our previous letters (e.g. contents of the foundations' articles of association; the many alterations these articles were subject to; the overlapping mandates of the foundations' governance body personnel with personnel employed by their creator, the Hungarian Central Bank (MNB); the clear and present ability of the MNB to determine their purpose and general policy; the MNB's right to nominate trustees and oversight

¹ [European System of Accounts 2010 \(Regulation \(EU\) No 549/2013\)](#) of the European Parliament and of the Council on the European system of national and regional accounts in the European Union).

board members; the financing being almost exclusively supplied by the MNB; etc.), in line with ESA 2.39 and 20.15, we consider it is beyond doubt that the foundations are controlled directly by the MNB and, given that, in line with ESA 20.311-313, the MNB is controlled by the Hungarian Parliament, the foundations are ultimately controlled by government.

As we have also written in our previous letters, given that the real and actual purpose of the foundations seems to be the execution of government policy and given the nature of their activity so far, we regard the foundations as units essentially performing government tasks and, thus, as non-market producers.

In sum, our conclusion remains that, for the purposes of statistical classification under ESA, the MNB's foundations are government controlled non-profit units and non-market producers and should, therefore, be classified in the general government sector (S.13). Likewise, subsidiaries established or later acquired by the foundations are deemed to be artificial subsidiaries and should, therefore, be consolidated with their immediate parent(s).

Our response to specific points raised

1. Independence of the foundations

We note your arguments essentially concluding that the foundations were set up in such a manner as to provide them full independence from both their creator (MNB) and government and that, therefore, they are not controlled by either.

We do not agree that this is the case. Considering the numerous statute changes, the MNB governor's declarations regarding the purpose and activity of the foundations, the multiple changes to the entire network of foundations and subsidiaries (mergers, acquisitions, absorptions), as well as the several overlapping personnel between the MNB and the foundations², the foundations cannot be regarded as being independent from either the MNB or government. As said before, in line with ESA paragraphs 2.39, 20.15 and 20.311-313, the foundations were and remain under the control of the MNB and, therefore, also of the government.

As explained in our previous letters, this case is one where the *substance-over-form* principle³ must be applied, as the actual activity of the entire network did and still does not coincide with its declared purpose. Moreover, while the real purpose of the foundations would still need to become fully clear, in our view, the declared purpose and scope warrants neither the size of the initial endowment, nor its flow rate, nor the dimensions of the entire network (the several foundations and the ever-growing number of subsidiaries).

2. Direct vs. indirect control

Your assertion that units controlled directly by another should receive separate treatment from those that are controlled indirectly (through other units in between) is interesting, but from the sector classification perspective under ESA it is not considered crucial. For sector classification purposes the ultimate controlling unit is decisive, i.e. the one which is at the upper end of the chain of control, also known as the *ultimate parent*.

² All these being arguments we have already presented in detail in our previous letters.

³ In the meaning of the principle foreseen under ESA paragraph 20.164, which is also known as the *substance-over-form* principle.

3. Autonomy of vs. control over a national central bank

Although some very specific cases may warrant special consideration⁴, as a general rule and in line with ESA paragraphs 20.311-313, national central banks enjoy particularly large autonomy in the exercise of their activity, but – nonetheless – they are controlled by their government (in the ESA meaning of the term, i.e. the general government sector). This is readily verifiable with the fact that governments do possess the ability to determine the bank's general policy through a simple change in law and by the fact that the governor is nominated by government.

The MNB is no special case in this respect: would the Hungarian Parliament (part of the Hungarian general government sector) wish to amend or significantly alter the MNB's policy, it could⁵. The ability is given, even if it (the rights it entails) would have yet to be exercised.

As a consequence, usually the chain of control does not end with the national central bank; it continues further to government. Hence, a unit controlled directly by the central bank is then also controlled – albeit indirectly, via the central bank – by government.

4. Loan vs. transfer (gift)

We also note your statements regarding the underlying nature of the initial endowment provided in several tranches by the MNB to the foundations. In summary, we understand that in your view these amounts should be recorded as *other capital transfers* (D.99), because you essentially view them as a gift.

As we have written in our previous letters, taking into account the specificities of this entire case, we consider the endowment to be a financing transaction, undertaken by the MNB on behalf of government. This is mainly because we are skeptical about the definitive nature of these transactions, i.e. here it does not seem likely that these amounts would or could never be recuperated. We raised this objection already at our ad-hoc visit of 2016: given that the sunset clauses in the articles of association of the foundations stipulate that in the event of dissolution, irrespective of cause, the net assets remaining after extinguishing all debts belong to the parent (MNB), in our view, the endowment is closer in its nature to a financing transaction undertaken by the central bank on behalf of its government, and would, therefore, be more accurately portrayed in national accounts as a loan granted by the founder (MNB) to government in the context of the implementation of government policy.

We would also like to clarify that the loan in question is deemed to have been incurred to finance the acquisition by the foundations of their government bond portfolios. Accordingly, the liquidation of that bond portfolio (its replacement by a real estate portfolio) would lead to a parallel reduction in the imputed loan against an entry in withdrawal in equity.

Therefore, in conclusion to this point, the initial endowment should be recorded as a financial asset (a loan with indeterminate maturity and no interest) and not as a transfer (gift).

5. Riksbankens Jubileumsfond (RJ)

We would agree that in essence, RJ (a non-profit unit) of the Swedish Central Bank is a very similar case to the MNB's foundations. The main difference is that RJ is in fact already classified in the central government subsector in Swedish national accounts, which is precisely the way in which we have advised the KSH to classify the MNB's foundations (and all their subsidiaries) in Hungarian national accounts.

⁴ As regards, in particular, the European Central Bank and the other members of the Eurosystem.

⁵ See law [CXXXIX of 2013](#) on the Hungarian National Bank.

Clarification request

Given the difficulties in following the consolidated financial position and performance of the entire network, due both to the many sequential demographic events (mergers, acquisitions, absorptions) and to the deficient annual reporting of several entities being part of the network (entire, materially important asset classes being omitted from disclosure in the annual reports) we have asked the KSH⁶, in line with Article 8 of the EDP Regulation⁷, to provide us with following information, deemed relevant by us for the further clarification of this case and to allow us to assess any potential reclassification impact on the 2017 Hungarian government deficit and debt figures:

- a breakdown per counterparty/issuer of balance sheet lines A.III. (long-term investments) and B.III. (securities), as at year-end 2017, for all foundations (PADA, PADMA, PAIGEO, PADE);
- same as above for line A.III. of Ferida Zrt, Kasselik-Haz Ingatlanfejlesztő Zrt and Optimum Beta Ingatlanbefektető Kft;
- an explanation (reconciliation) for following differences:
 - Optima Befektető Zrt's shareholding in Seven House Ingatlanhasznosító Kft of 2897 mHUF and the latter's equity of 146 mHUF;
 - Optimum Beta Ingatlanbefektető Kft's shareholdings in Ari Ingatlanforgalmazási és Hasznosítási Kft and in Immker Kft totalling 17247 mHUF and the combined equity value of the latter two of 1373 mHUF;
- an explanation (breakdown similar as in the first bullet point above) on what the 74600 mHUF injected by Optima Befektető Zrt into the Optimum I. investment fund was further invested into.

Since the reply⁸ of your services on our initial enquiry was not complete and considering our unchanged conclusion on this sector classification case, we would like to kindly ask you to provide the above requested information, in its full details, by 30 September 2018.

Yours sincerely,

(eSigned)

Mariana Kotzeva

⁶ In our e-mail from 12 July 2018.

⁷ [Council Regulation \(EC\) No 479/2009](#) of 25 May 2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community.

⁸ Your e-mail from 4 September 2018.