



EUROPEAN COMMISSION
EUROSTAT

Directorate D: Government Finance Statistics (GFS) and quality

Luxembourg,
ESTAT/D-3/EBC/JV/PL/eb/D(2014)1931556

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Subject: Recording of transactions relating to the nationalization of SNS Reaal in Q1 and Q4 of 2013

Ref: your letter sent on 25 July 2013
our letter sent on 14 October 2013
your letter sent on 22 October 2013
our letter sent on 17 December 2013
your reply sent on 17 and 20 March 2014
our letter sent on 28 March 2014
your reply sent on 4 April 2014

Dear Ms Imbens,

Thank you for your letter sent on 4 April, relating to the statistical recording of the Dutch government's capital injection into the (nationalised) SNS Reaal, and the recording of transactions related to separation of SNS Property Finance. This letter provides Eurostat's views on both issues.

The accounting issue

The statistical authorities of the Netherlands have informed Eurostat of their proposed recording of the transactions related to the nationalization of SNS Reaal in the first quarter of 2013, and on the classification of the separated Property Finance Vehicle and the statistical recording of its creation.

Documentation provided

The Statistics Netherlands (the CBS) has previously provided a description of the capital injection in the first quarter of 2013 and proposed an accounting treatment. The CBS replied on 22 October 2013 to the Eurostat letter sent on 14 October 2013, and explained the case further during the EDP dialogue visit on 26 November 2013. Eurostat sent a further letter on 17 December 2013 and the CBS send further letters on 17 and 20 March. The latest letters were exchanged on 28 March and 4 April.

Description of the case

In January 2013, the Dutch State nationalised SNS Reaal (public limited company), including SNS Bank and its subsidiary SNS Property Finance. The nationalisation involved four main events in the first quarter of 2013:

1. Expropriation of shares and subordinated debt by the Dutch State;
2. Conversion of core tier one securities from 2008 into ordinary shares;
3. Capital injections worth EUR 2.2bn into SNS Reaal by the Dutch State;
4. Provision of a loan worth EUR 1.1bn by government to SNS Reaal.

Furthermore, the CBS informed Eurostat that in the fourth quarter of 2013, *a separation of SNS Property Finance from SNS Reaal* took place.

According to your description, the Minister of Finance announced at the time of nationalization that the real estate portfolio of SNS Property Finance would be separated from SNS Bank and put in a separate unit Property Finance Vehicle with the sole task to manage and unwind these ‘bad’ assets. Following investigation of State Aid issues, this separation eventually took place on 31 December 2013, by SNS Bank transferring this subsidiary to the ownership of the Dutch State, operating under its new name, Propertize, and with new articles of association.

Applicable accounting rules

Regulation (EU) No 549/2013 of the European Parliament and of the Council, which incorporates the national accounts concepts and definitions of the European System of Accounts (ESA 2010) in Community Legislation in its entirety and is directly applicable in all Member States, is due to be implemented starting from September 2014. The Dutch authorities have informed Eurostat that they will publish ESA 2010-based data at a national level in June 2014. Therefore, in this letter Eurostat bases its analysis on ESA 2010 rules.

The ESA 2010 Manual on Government Deficit and Debt (MGDD) chapter III.2 Capital injections into public corporations, and chapter IV.5 Financial defeasance, are to be applied.

Moreover the specific rules for financial institutions are to be applied: (1) Eurostat's decision and corresponding guidance note "*The statistical recording of public interventions to support financial institutions and financial markets during the financial crisis*", dated 15 July 2009, (2) Eurostat's guidance note "*The impact of bank recapitalisations on government finance statistics during the financial crisis*" dated 18 July 2012 and (3) Eurostat's decision on the "*Clarification of the criteria to be taken into account for the recording of government capital injections into banks*", dated 19 March 2013.

1. Recording of the capital injection of government into SNS Reaal

Availability of national accounting analysis

Regarding the recording of the capital injection of EUR 2200 million in national accounts the CBS initially proposed to record this fully as an acquisition of equity. The CBS argued that "*if State receives something in return, the injection should be recorded as a financial transaction*". Moreover, they explained that the past losses are borne by the private shareholders, and, a sufficient rate of return is expected, as the bad assets will be removed to a separate unit and "*future write-down are expected to be nil or small*".

In the letter of 17 March 2014, the CBS confirmed again its belief that the capital injection is an investment in ESA terms. After examining the restructuring plan and the 2013 results, it is of the

view that the retail bank activities are likely to yield a high level of return, although this is not expected to be the case for the insurance activities.

The Dutch authorities also emphasized that in case Eurostat is taking into account past losses in the analysis, then the loss absorption of them should also be taken into account. Concerning the expropriated shares, the CBS held the view that that the deductions should be based on market value of the shares. They also mention three cases (in 2007, 2008 and 2009) of capital injections by shareholders in their letter, where shareholders were substantially contributing to the own funds. As a consequence, the CBS see the best measure of Eurostat's view to include past shareholders' injections as decreasing past losses. Later, in its letter of 4 April the CBS expressed its view that, taking into account all three capital injections, the CBS arrives at a capital transfer of at most EUR 500 million.

Previously agreed recording issues

Eurostat, in its letter sent to the CBS on 22 October 2013, agreed with the CBS concerning the recording of the expropriation of shareholder and subordinated debt holders as other changes in volume (K.8 uncompensated seizure, according to ESA95) counterbalanced by F.512 unquoted shares (ESA95). Eurostat asked the CBS to provide in due course any further information on the possible compensation of expropriated security holders and their recording in national accounts.

Eurostat endorsed the proposed accounting treatment concerning the conversion of core tier 1 of government held SNS securities, that is to keep the current recording unchanged in national accounts as unquoted shares, F.512.

Concerning the loan of EUR 1100 million, provided by the Dutch government, Eurostat agreed, that in the absence of any irrefutable evidence that the loans will not be repaid, these should be recorded as short term loans (F.41) in national accounts.

Analysis

In its previous letters, Eurostat explained that when analysing this capital injection, the provisions of the MGDD chapter III.2 Capital injections into public corporations have to be applied. Furthermore, according to the guidance note on "*The impact of bank recapitalisations on government finance statistics during the financial crisis*" from 18 July 2012¹, in case the government nationalises a financial institution, a reference to the *general rules of capital injections into public corporations have to be applied*. The basic principle is that if government is **acting in the same capacity as a private shareholder**, the capital injection is to be recorded as a financial transaction. On the other hand, in *the absence of the private shareholders contributing to the capital injection, under the same conditions as government, bearing the same risks and gaining the same rewards*, capital injections have to be fully or partly recorded as capital transfer in case government provides funds without receiving anything of equal value *OR* without expecting a sufficient rate of return *OR* with the funds being provided to a corporation that has shown losses in the past.

The CBS argued in its original letter that even a private investor would have participated in the recapitalisation. However, Eurostat notes that according to the CBS's analysis "*the Proposal of CVC was rejected by the Ministry of Finance. It found that the risks for the State were not proportional to the size of the benefits for CVC*" and believes that this signifies that the private party would have participated only if it received a guarantee from the State on its investment – which

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http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/Impact_bank_recapital_on_gov_fin_v20130514.pdf

does not therefore confirm the private investors' willingness to participate under the original conditions.

In its second letter, the CBS further explained that the Dutch government acted exactly as a private investor when it rejected the deal with CVC, as it believed that the eventual nationalization would deliver more benefits to the State.

Eurostat however retains the argument that no private investor would have participated in the rescuing of SNS Reaal without the involvement of government. Even if CVC would have closed a deal, it would have had heavily relied on the support and involvement of government. Moreover, no non-government body can "nationalise" and simultaneously "expropriate" shares and debts. Therefore there was no private investor ready to invest under the same conditions as government.

Consequently, the statistical analysis should proceed for a case without private investors, meaning that the two criteria from the MGDD have to be examined in order to classify the capital injection as an acquisition of equity or a capital transfer. These are: (i) the existence of accumulated net losses and (ii) the existence of the sufficient rate of return.

i) The existence of accumulated losses

Eurostat underlines that the rules in the MGDD corresponding to capital injections must be applied, and notably the operational guidance provided in chapter III.2.2.1 §11. This is an approach which is applied in all Member States and, as can be seen from the supplementary tables on the financial crisis, has led to the recording of deficit-increasing impacts across many Member States in the context of government injections into, and rescues of, financial institutions. The net results of SNS Reaal's annual reports indicate that since 2008 and up to end-2013 SNS Reaal had accumulated EUR 3555 million of losses.

In addition, there were further losses to be expected arising from the creation of Propertize, where government made a EUR 500 million capital injection in the fourth quarter of 2013, which was already foreseen in February 2013. Thus the sum of total losses is 4055 EUR million.

ii) Existence of sufficient rate of return

The CBS has analysed the *restructuring plan* for SNS Reaal, though unfortunately the details have not been made available to Eurostat. The plan is said to indicate that SNS Reaal will be "viable" in the long term – providing the insurance activities can be satisfactorily delinked – and that there will be a profit-making retail bank. However there is no indication of the time-scale for this, nor the level of return which the government may be expected to realise from its holding, which are relevant for statistical analysis. Also, on 23 May 2014 the European Commission (DG Competition) published its decision on the state aid case "SA.36598 Restructuring of SNS REAAL", which excludes confidential information such as the financial projections of the restructuring plan.

iii) Absorption of losses by private shareholders

The full amount of accumulated/expected losses (EUR 4055 million) should not be, however, taken into account in determining the government deficit impact because private shareholders have already absorbed part of the accumulating losses through their capital injections during 2007-2009 and by expropriation of their securities by the Dutch government.

Capital injections by private shareholders

The capital injections made by private shareholders in 2007 (350 EUR million) and 2008 (600 EUR million) were linked to acquisitions relating to the expansion of insurance activities of SNS Reaal. These acquisitions were subsequently subject to impairment of goodwill in IFRS-based accounts,

which formed part of the net losses of SNS Reaal in later years. The capital injection made in 2009 (135 EUR million) was used for the repayment of 250 EUR million liabilities against the Dutch State and the Stichting Beheer SNS Reaal. In Eurostat's view, for these specific reasons, the three capital injections (total 1085 EUR million) should be deducted from the total losses.

Expropriation of securities

Eurostat agrees that private shareholders and subordinated debt holders bore part of the losses at the time of expropriation and should be therefore also deducted from the total losses. Using the market value of the quoted shares leads to a total loss borne by shareholders and debt holders of EUR 1840 million at the time of the rescue, as detailed in table 1 below.

Table 1. Value of the expropriated securities

Expropriated instruments	Number of securities	Nominal value (EUR)	Market value (EUR)	Aggregated value of the expropriated instruments (EUR)
Quoted shares	287,619,867.00	1.63	0.84	241,888,308
Core tier 1 securities, Stichting Beheer	107,619,045.00	96.63		435,000,000
Participation certificates and subordinated debt				1,163,000,000
Total				1,839,888,308

The total amount of losses absorbed by private shareholders is EUR 2925 million.

This would lead to the conclusion that the total loss to be assigned to the capital injection of EUR 2200 million made in the first quarter of 2013 by central government would be EUR 1130 million. This is the total capital transfer from government to SNS Reaal to be recorded in the first quarter of 2013, with the counterpart of currency and deposits (F.2) in the financial accounts. The remaining amount, EUR 1070 million, is to be recorded as an acquisition of equity (F.5) by government, with no impact on the government deficit.

Other issues to be considered

Own funds

In its second letter, the CBS contested that Eurostat does not take into account that the Dutch government acquired a company with substantial own funds higher than its capital injection. With the increased own funds, the government receives more in return than it pays.

However, the existence of positive own funds is not a criterion applied in the MGDD when deciding about the classification of a capital injection. Investment in a corporation with positive own funds does not necessarily guarantee the government a market rate of return.

Deferred tax assets

The CBS has also mentioned that deferred tax assets need to be taken into account as one-off gains absorbing losses directly. Eurostat would like to emphasize, however, that deferred tax assets cannot be taken into account for absorption of losses as they are considered as contingent assets in national accounts when not transferrable, as discussed at the December 2013 Financial Accounts Working Group meeting.

Recording of the possible compensation

In its original letter Eurostat argued *"In the case any compensation would be paid to the shareholders and creditors, this has to be recorded in national accounts only in the financial accounts, as it was an acquisition of equity (therefore most probably recorded as other accounts payable (F.7, ESA95) counterbalanced by currency and deposits (F.2)). The Dutch authorities are asked to inform Eurostat in due course of any progress on the work of the expert committee for compensation."*

In its second view, the CBS asked whether Eurostat proposes to record an other change in assets and not F.7 (ESA95) as there is no timing difference between the cash payment and the accrual time of recording of a non-financial or financial transaction. Moreover, the Dutch authorities felt that in the case of a compensation a capital transfer is a more appropriate recording.

Reconsidering these arguments, Eurostat acknowledges that the possible compensation should be preferably recorded as capital transfer by government to the former owners of the securities, at the time of the Court decision. This would be reasonable, taking into account that the statistically calculated value of the expropriated shares was taken into account (subtracted) when calculating the proposed amount of the capital transfer above.

2. Recording of the separation of the SNS Property Finance

Availability of national accounting analysis

In its letter of 20 March 2014, the CBS shared its analysis on the recording of transactions related to the separation of the SNS Property Finance. This separation took place on 31 December 2013, by SNS Reaal transferring this subsidiary to the Dutch State, operating under its new name, Propertize, and with new articles of association.

The Dutch authorities propose to classify Propertize as a government controlled defeasance structure. This is based on the fact that Propertize satisfies the features of a defeasance structure, regarding the indicative list of MGDD (chapter IV.5.2.1 §9), such as being closed to deposit taking or to new lending, working under strong externally imposed restrictions and, a limited lifetime is foreseen.

When looking at the fact whether Propertize puts itself at risk, the Dutch authorities find the criteria on the risk borne by the government not completely clear (whether the amount of the guarantee fee is a decisive criterion on deciding the risk allocation), however they conclude that the government bears majority of the risks associated with the activities of Propertize, therefore classifying it as a general government unit.

The recording of the reclassification of Propertize is proposed to be recorded as an other change in volume (i.e. without impacting government deficit). Whereas the impact of reclassification was EUR 4809 million, the debt of Propertize was decreased by EUR 400 million after the reclassification. Therefore the gross government debt effect was around EUR 4400 million at end-2013.

Statistics Netherlands also mention that the Dutch government injected EUR 500 million in the Propertize after the transfer, which is recorded as a capital transfer between two government units (D.99).

Analysis

Eurostat agrees with the CBS on the classification of Propertize as a government controlled financial defeasance structure, as it satisfies the criteria set out in the MGDD chapter IV.5. Eurostat also considers that Propertize does not put itself at risk, therefore is to be classified inside general government. Concerning the doubts of the CBS on the amount of the guarantee fee as a "necessary" condition for the risk assessment, Eurostat thinks, that in MGDD chapter IV.5.2.1 §11 it is quite clear that the quoted part on the guarantee fee is just an example.

The paragraph in its entirety says:

*"11. When there is evidence that the government is assuming the majority of the risks associated with the activities of the government-controlled defeasance structure, as described above, this structure is to be classified inside the general government sector, whatever its legal status. **For instance**, government is committed to cover the majority of the expected losses from the assets, through providing guarantees on the financing of the entity holding the problematic assets and the guarantee fee is not in line with the risks involved, and/or the main source of financing is the public sector. The entity should be classified inside the general government sector from its creation (case 1 mentioned above) or reclassified (in case 2)."*

Therefore the existence of a guarantee fee is only an indicative criterion. The deciding factor is the assumption of the majority of the risks.

Eurostat agrees with the CBS that Propertize is to be classified to general government sector as of end-2013 and to record the reclassification as an other change in assets (K.6).

However, this reclassification would not lead to deficit impact as the calculation of total losses (as described above) already takes into account the expected losses for government relating to separation of this unit from SNS Reaal during 2013, i.e. the EUR 500 million capital injection in the fourth quarter of 2013, which was already foreseen in February 2013. Eurostat also agrees that the mentioned injection (EUR 500 million) is recorded as a capital transfer between two government units in the fourth quarter of 2013.

Eurostat agrees with the Dutch statistical authorities on the recording of the other transactions involved.

Conclusions

Eurostat agrees with the CBS concerning the recording of the expropriation of shareholder and subordinated debt holders as other changes in assets (K.4 uncompensated seizure) counterbalanced by F.512 unlisted shares. Eurostat asked the CBS to provide in due course any further information on the possible compensation of expropriated security holders and their recording in national accounts but for now agrees with the Dutch statistical authorities that a possible compensation should preferably recorded as a capital transfer at the time of the Court decision.

Eurostat agrees with the proposed accounting treatment concerning the conversion of core tier 1 of government held SNS securities, that is to keep the current recording unchanged in national accounts as unlisted shares (F.512).

Concerning the loan of EUR 1100 million, provided by the Dutch government, Eurostat agrees, that in the absence of any irrefutable evidence that the loans will not be repaid, these should be recorded as short term loans (F.41) in national accounts.

Regarding the separation of the SNS Property Finance, Eurostat shares the view of Statistics Netherlands, that Propertize, the vehicle taking over the bad assets, is a public financial defeasance

structure, classified inside government, as government is controlling it and bearing the majority of the risks associated with its activities. The reclassification is to be recorded as an other change in assets (K.6), i.e. without impacting government deficit. The gross debt of Propertize of some EUR 4400 million would therefore add to government gross debt at end-2013.

Eurostat concludes that the total losses to be taken into account in analysing the capital injection of EUR 2200 million is 4055 EUR million, which includes the net results of SNS Reaal in 2008-2013 (EUR 3555 million) and expected losses for government relating to separation of SNS Property Finance from SNS Reaal (EUR 500 million). These losses are, however, considered as being partly absorbed by the capital injections by private shareholders in 2007-2009 (total EUR 1085 million) and expropriation of securities at the time of the nationalisation of SNS Reaal (EUR 1840 million).

Therefore, the total loss to be assigned to the capital injection of EUR 2200 million made in the first quarter of 2013 central government would be EUR 1130 million, impacting the government deficit.

Procedure

This view of Eurostat is based on the information provided by the country 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 the Eurostat website. In case you have objections concerning the publication of this specific case, we would appreciate if you would let us know *before 23 June 2014*.

Yours sincerely,

(eSigned)
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