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Sector classification of the Sociedad de activos de Reestructuracion (SAREB)

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EUROPEAN COMMISSION
EUROSTAT

Directorate D: Government Finance Statistics (GFS)
Unit D-1: Excessive deficit procedure, methodology and GFS

Luxembourg,
ESTAT/D1/LA/RJ/SF/ps

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Spain

Subject: Sector classification of the *Sociedad de activos de Reestructuración (SAREB)*

Ref.: Follow-up of the 2019 EDP dialogue visit (Action point 23)

Dear Mr Cristóbal,

Thank you for your note dated 25 January 2021 on the sector classification of SAREB as a follow-up of the Action point 23 from the 2019 EDP dialogue visit dated 27-29 November 2019¹ as well as a follow-up of the discussions held in the videoconferences on 12 June 2020 and 3 July 2020.

The case

The issue for which an opinion is being sought is a determination of the correct ESA 2010 accounting treatment of the classification of the *Sociedad de activos procedentes de la reestructuración bancaria (SAREB)*.

Description of the case

SAREB was created in November 2012, in the context of the financial assistance programme, as part of the Memorandum of Understanding² signed between Spain and the European Commission, to assist the restructuring and recapitalisation of the Spanish banking sector. SAREB was created with a limited lifespan of 15 years. SAREB was mostly owned by private entities (54 %).

At inception, taking into account the Statute of SAREB, ESA 1995, the 2012 Manual on Government Deficit and Debt (MGDD) and the special rules of Eurostat that were in

¹ <https://ec.europa.eu/eurostat/documents/1015035/9983802/Final-findings-EDP-dialogue-visit-ES-27-29-Nov-2019.pdf/cbc99c7d-c2de-af36-f3d6-59734f6f168e>

² https://ec.europa.eu/economy_finance/publications/occasional_paper/2012/pdf/ocp118_en.pdf

force for the duration of the financial crisis (*“The statistical recording of public interventions to support financial institutions and financial markets during the financial crisis”*), SAREB was classified as a private financial institution not controlled by government.

As stated in Eurostat's decision on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis (15 July 2009), five main conditions were to be met simultaneously in order for such a special purpose entity to be classified outside general government:

- it had to be an institutional unit;
- it had to be majority privately owned (54 %);
- the main purpose of the new unit had to address solely the financial crisis;
- the unit was to be established with a short, temporary duration (for 15 years);
- the expected losses, if any, that the unit would bear had to be small in comparison with the total size of the liabilities (according to the business plan, it was reported to Eurostat by the Spanish authorities that the company would have had an expected return on equity of around 13%).

As the above-mentioned conditions were considered to be met in 2012, Eurostat accepted the Spanish statistical authorities' analysis that SAREB should be classified in the financial corporations sector (S.12). An advice letter was published on the Eurostat website³. SAREB has been classified in S.12 since 2012.

Further developments

SAREB issued debt to finance the purchase of assets for a total amount of 51 billion euro. Up to mid-2020, SAREB has redeemed about 31% of its senior debt for a total amount of about 15.6 billion euro. Hence, the outstanding senior debt currently amounts to around 35.4 billion euro. The whole senior debt of SAREB is guaranteed only by government.

Out of the initial total debt of SAREB, 3.6 billion euro were subordinated debt. In 2016, 2.1 billion euro were converted into equity, of which 996 million euro concerned shares owned by government - FROB (45.90 %), with an impact on government deficit, given the fact that the conversion into equity was undertaken to cover past losses.

The current shareholder structure is almost unchanged from the original structure, with some negligible differences in terms of percentages held (due to the conversion of subordinated debt in 2016). FROB holds 45.9% of capital and outstanding subordinated debt.

Losses have been incurred every year since SAREB's creation and the figures observed in the financial reports are as follows (in million euro):

³ <https://ec.europa.eu/eurostat/documents/1015035/2990735/ES-Classification-of-SAREB.pdf/95a10697-19f3-4387-a457-12f87f341242>

Year	SAREB's net losses
2013	261
2014	585
2015	103
2016	663
2017	565
2018	878
2019	947

In the first half year of 2020, losses amounted to 399 million euro.

The FROB, which owns 45.9% of SAREB, has now valued its majority stake of about 2.2 billion euro at zero, as reported in its 2019 annual accounts. The FROB has been recognising the losses gradually in recent years and, after the last provision of 169 million euro in 2019, its stake was valued by the FROB itself at zero. The FROB considered that its investment in SAREB is now lost.

The FROB's annual report states the following: *“At December 31 2019, based on the business plan of SAREB in the view of the objective evidence of impairment, as per the most conservative scenarios, an impairment loss has been registered for an amount of 169 million euro ... on the accompanying income statement of such year, thus being fully impaired at December 31, 2019”*.

According to SAREB's 2020 six-monthly report, *“the losses for previous years and the current year have used up all of the company shareholders' equity in 2020. The shareholders' equity plus the subordinated debt (convertible to capital in the event of insufficient equity) amount to 1,261 million euro. Current forecasts envisage that the losses will consume the company's entire shareholders' equity and subordinated debt during the first half of 2021. However, following the passing of Royal Decree-Law 6/2020, of 10 March, this negative equity situation will not mean the company being subject to grounds of dissolution, but it will be able to continue carrying out its activity as normal”*.

The 2019 EDP dialogue visit

During the 2019 EDP dialogue visit, Eurostat underlined that the decision on the sector classification of SAREB was made in 2012, in line with the ESA 1995 and the 2009 Guidance note. Eurostat disputed the argument that the conditions, as set in the Guidance note, were still valid.

The issues below were raised by Eurostat during the 2019 EDP visit and are included in the Final findings, which are published on the Eurostat website.

Firstly, the expected losses of SAREB are very sizeable (about 7 billion euro by end-2018) in comparison to its liabilities (36 billion euro). Moreover, the business plan, as presented to Eurostat in 2012, which projected a return on equity equal to 13%, was

clearly not fulfilled. Finally, the annual report of SAREB itself indicated that the losses would continue also in the future.

Secondly in the case of SAREB, government enacted a special regulation valid only for SAREB (*Real Decreto-ley 4/2016*), in order to prevent its liquidation, by excluding losses. This special regulation, tailor-made only for SAREB, is in fact also indicative of the fact that SAREB should be considered as a public entity, according to ESA rules.

Furthermore, the accounting rules have since been changed and clarified. While ESA 1995 was not very explicit on the distinction between public and private ownership, ESA 2010, in force since 2014, is clear on this issue in paragraph 20.309.

In light of the above discussions, in 2019 Eurostat asked the Spanish statistical authorities to reflect on the sector classification of SAREB mainly given that:

- There were sizeable accumulated losses (about 7 billion by end-2018) against the projected sizeable profits presented to Eurostat in 2012 in the business plan of the company;
- The entry into force of ESA 2010, and in particular para 20.309 on various modalities to assess public control;
- The fact that similar entities in other Member States originally classified outside S.13 have, in the meanwhile, been re-classified in S.13 by national statistical authorities;
- Government enacted a special regulation only for SAREB (*Real Decreto-ley 4/2016*), which would point to public sector control according to ESA 2010 para 20.309.

Opinion of the Spanish statistical authorities

The Spanish statistical authorities proposed, on the contrary, that SAREB remain classified in the financial corporations sector (S.12). It is claimed that, as government has not yet acquired a majority of the SAREB's shares, it has not decided to enlarge its lifespan and no other business than those related to the liquidation of assets arising from the financial crisis has been entrusted to SAREB, the company should remain classified outside the general government.

In addition, they do not agree to apply the ESA 2010, as these rules were not in force at the moment in which SAREB was created.

However, the Spanish statistical authorities did acknowledge that the current financial situation of SAREB indicates that at least a part of its debt would not be redeemed through the disposal of its assets. As the senior debt of SAREB is guaranteed by the government and the negative net worth of SAREB must be recovered, the following recording was proposed by the Spanish authorities for the year 2020:

- SAREB would not be re-classified in the general government, but would remain classified in S.12;
- a partial debt assumption and a capital transfer with an impact on government deficit and debt would be recorded for the amount of the negative net worth (about 8 billion euro), as a proxy of the guarantee call on the outstanding debt (very likely to take place in any case in 2027).

Methodological analysis and clarification by Eurostat

Applicable accounting rules

- *Regulation (EU) No 549/2013 of the European Parliament and of the Council incorporates the national accounts concepts and definitions (ESA 2010) in Community Legislation*, in particular paragraph 20.309 on Public sector control. It is in its entirety directly applicable in all Member States.
- *Manual on government deficit and debt (MGDD), 2019 edition*, in particular chapter 4.5 on Financial defeasance.

Methodological analysis and clarification by Eurostat

Eurostat considers that SAREB should be re-classified inside the general government sector (S.1311). As the conditions set in the 2009 Guidance note are no longer valid in the case of SAREB (as also agreed by the Spanish statistical authorities) and ESA 2010 and the latest version of the Manual of Government Deficit and Debt are applicable now, SAREB has to be analysed in line with the ESA 20210 rules.

The main reasons for the re-classification of SAREB in the general government sector according to the current rules are explained below.

Firstly, the decision on the sector classification of SAREB was made in 2012, in line with the ESA 1995 and the 2009 Guidance note on “*The statistical recording of public interventions to support financial institutions and financial markets during the financial crisis*”⁴. During the 2019 EDP visit, Eurostat disagreed with the argument that the conditions, as set in the Guidance note, were still valid.

This is in particular the case for the sizeable accumulated losses (around 8 billion) against the projected very sizeable profits presented to Eurostat in 2012 in the business plan of the company. As the profitability (or very limited losses) of the company is one of the necessary conditions for the entity to be classified outside the government sector, the sheer size of the losses would in any case preclude now the classification of SAREB outside government. This is also recognised by the Spanish authorities, which indicated in their note dated 25 January 2021 that “*this condition has not been met*”. Moreover, the annual report of SAREB itself indicated that losses would continue also in the future.

In line with the above-mentioned argument, Eurostat considers that the conditions as set in its Guidance note are no longer valid in the case of SAREB and therefore, SAREB cannot remain classified outside general government.

Secondly, and importantly, the rules have been changed and clarified following the entry into force of the ESA10. While the ESA 1995 was not very clear on the distinction between public / private ownership, the ESA 2010 is fully applicable now. Eurostat

⁴ <https://ec.europa.eu/eurostat/documents/1015035/2041357/Eurostat-guidance-note-FT-10-September-2009.pdf/eae8874d-3e2e-401d-b3cf-50063473bb0b>

would like to recall that whenever one reference methodology (ESA 1995) is being replaced by a new one (ESA 2010), statistics have to follow the new accounting standards consistently, therefore the appropriate revisions should be implemented for the whole time series (e.g. starting from the 1995).

ESA 2010 paragraph 20.309 defines the public sector control indicators, which are broader than ownership. For example, the special regulation, tailor-made by the government for SAREB (*Real Decreto-ley 4/2016*) is actually indicative of the fact that SAREB should be considered as a public entity in national accounts according to ESA rules.

Thirdly, also according to the latest 2019 version of the MGDD, SAREB should be reclassified inside government due to the fact that the whole senior debt of SAREB is guaranteed by government. Paragraph 11 of the Chapter 4.5 on Financial defeasance clearly states, *“When there is evidence that government is assuming all or the majority of the risks and rewards associated with the activities of a government-controlled defeasance structure, as described above, this structure is classified in 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, or that the main source of financing is from the public sector. The entity should be classified in the general government sector either from its creation (case 1 mentioned above or a point of reclassification - case 2).”*

Fourthly, due to the end of the financial crisis and to the entering into force of ESA10, the defeasance structures in the other Member States concerned have been already reclassified in the general government sector. SAREB therefore now constitutes an exception.

Finally, the 2019 FROB annual report valued its majority stake of about 2.2 billion euro in SAREB at zero in 2019. Also according to SAREB’s 2020 report, the losses have used up all of the company shareholders’ equity in 2020 and the forecasts envisage that the losses will consume the company’s entire shareholders’ equity and subordinated debt during the first half of 2021. Only due to a special regulation for SAREB, the company will not have to be dissolved, but it will be able to continue carrying out its activity as normal.

Conclusions

Eurostat considers that, according to past and current rules and the above-mentioned arguments, SAREB should be reclassified inside the government sector (S.1311) in the context of the April 2021 EDP notification.

In line with paragraph 11 of Chapter 4.5 on Financial defeasance of the MGDD, Eurostat would ask the Spanish statistical authorities to decide whether the re-classification should take place either from its creation (i.e. in 2012) or from 2020 onwards. The two possibilities are both contemplated by the present rules in force in the MGDD.

Eurostat would like to recall that, in case the Spanish authorities decide to reclassify SAREB backwards from its inception in S.1311, losses would be recorded, in national accounts, when realised, and the government deficit would be impacted every year following the incurred losses. The total government debt would be increased in 2012 by roughly 51 billion euro and it would be reduced over time to 35.4 billion in 2020, with a descending trajectory.

In case the Spanish authorities decide that SAREB should be re-classified in S.1311 in 2020, Eurostat would like to recall that special rules exist for defeasance structures. Therefore, the re-classification in 2020 would be considered as if the unit was created in 2020. The impact on government deficit would be equal to negative Net assets – Net worth (difference between assets – liabilities). In the future, only realised losses that exceed the capital transfer booked at the moment of reclassification in 2020 would have to be imputed.

We would appreciate to receive your reply by end-February 2021 and to learning your preference as to whether SAREB should be reclassified in 2012 or in 2020.

Yours sincerely,

(e-Signed) Luca Ascoli

Director