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Early Warning System - Case 10

Financial services group

Final methodological assessment - prepared by the EWS secretariat with input of the ECB and the approval of relevant EWS network members

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Description of the case

The case concerns the restructuring of a financial group. This includes creation of branches from previous subsidiaries and relocation of the group headquarter (HQ hereafter).

Assessment

Based on the information mainly provided by countries involved in the restructurings, this financial institution has undertaken three major structural operations in 2017 and 2018:

Operation 1: January 2017: "branchification" of the group. Balance sheet items were transferred from subsidiaries in country A (euro area country) and two non-euro area countries to the (then) corporate HQ in country B (non-euro area country). The transfer was carried out so that the previously existing wholly owned subsidiaries became branches to the country B parent company (excluding some subsidiaries that remained due to their operations in covered bonds issuing). The subsidiaries ceased to exist as a consequence of the transfer. The branches are institutional units (quasi-corporations) in the country they operate, and continue the activities of the subsidiaries.

Operation 2: October 2017: new financial institutions in several EU-countries where created as balance sheet items of branches to the financial institution from country B were sold to an existing holding company in country B. Subsidiaries of another financial institution (outside of EU) were also sold to the holding company, which in turn was owned as a joint venture by the financial institution in country B and the financial institution in a country outside of EU. This operation is not directly related to the restructuring in operations 1 and 3.

Operation 3: October 2018: formal move of the institution's HQ from country B to country A, accompanied by a transfer of balance sheet items into a holding corporation (licensed as a bank), which is subsequently renamed and assumes role of corporate HQ and disappearance of the institutional unit in country B. New branches were established which are branched to HQ in country A instead of former HQ in country B. Loans made in country B (i.e. to country B residents) remain in the balance sheet of a branch in country B after the HQ move to A. Even though the legal form and ownership has changed, the business activities have not been much affected by the restructuring operations 1 and 3, at least in the short run.

In each case, substantial sums of financial assets and liabilities have moved between balance sheets as a result of each of the three operations above. The key conceptual question is if the concerned countries should record these movements as transactions or as other economic flows (reclassifications).

The conceptual references for this question are:

- ESA2010 paragraphs 6.19 - 6.20; 21.25 - 21.27
- ESA95 paragraph 6.30
- BPM6 paragraph 8.19, 9.21, 9.23
- SNA2008 paragraph 21.21

The general approach for answering the question is consistently referenced, and therefore the recording of the operations should be the same across national accounts, balance of payments and monetary and financial statistics.

Based on this, the guiding principle is whether or not the units involved in the operation appear/disappear at the time of the operation. If the units involved do appear/disappear, then the operation should be treated as other economic flows (reclassifications). If this is not the case, then it should be treated as transactions.

Applying this guidance to the operations above:

Operations 1 and 3 both involve the appearance/disappearance of the involved units, and should therefore be recorded as other economic flows (reclassifications). (An alternative view, suggested by the NSI of country B, is that B's part of the group should be seen as the one and the same institutional unit before and after the reconstruction. This would lead to the same conclusion as above, i.e. recording as reclassifications.)

Operation 2 does not involve the appearance/disappearance of the involved units (the holding company in country B was an existing unit) and should therefore be recorded as transactions.

Conclusions

Based on the information provided and the conceptual references in the relevant manuals described above, it is concluded that:

- The way of recording of the operations should be consistent across national accounts, balance of payments and monetary and financial statistics;
- If the units involved in the restructuring do appear/disappear as a consequence of an operation, then this operation should be treated as other economic flows (reclassifications) [Operations 1 and 3]. If this is not the case, then the operation should be treated as transactions [Operation 2].

Impact on statistics

The main impact is probably on the statistics on the International investment position (IIP). IIP shows at a point in time the value of financial assets of residents of an economy that are claims on non-residents and the liabilities of residents of an economy to non-residents.

Operation 3, the relocation of HQ from country B to country A, shows up in the two countries' IIP statistics in 2018 Q4, for the sector *Monetary financial institutions*. The foreign assets of monetary financial institutions grew significantly in country A, and fell by a similar amount in country B. Both NSIs mention the restructuring in their news releases. Country B mentions explicitly that this is not related to transactions but to other changes.

Eurostat published the IIP data for 2018 Q4 in early April 2019. However, the data is available only for the total economy, and not the different sectors, so the changes are less visible.