European Commission

CMFB WORKSHOP ON THE CLASSIFICATION OF

DEVELOPMENT BANKS

Sector classification and rearrangement of transactions

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Unit D.1 – Excessive Deficit Procedure and methodology

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A brief recall

- **National development banks** (often referred to as promotional banks): active (mainly) on the domestic market

- **Foreign development banks** (for foreign development): active to support the government's development aid policy in developing and emerging markets

A brief recall

- DBs are usually wholly government-owned but mixed ownership or even full private ownership is possible
- DBs are often not banks in the legal sense (i.e. deposit-taker)
- DBs have an explicit policy mandate, i.e. they provide mainly financial services to targeted groups on less than fully commercial terms (e.g. concessional loans)
- DBs provide services which are usually complementary to that of commercial banks

A brief recall

- DBs are more likely than other government-owned entities subject to political influence that goes beyond the framework set out in the mandate:
  - Other government-owned entities operate usually in a defined industry whereas DBs operate in a broader scope
  - Asymmetric information about the 'quality' of a specific transaction makes it easier to camouflage political motivation
  - Possibility to move the costs of the government influence to the future
  - Easier to control/direct financial resources than to remove entry barriers or implement structural changes in other sectors.

Statistical issues in EDP/GFS

- In which sector should a development bank be classified?
  - General government sector
  - Financial corporations sector
- Are some activities of a development bank to be rearranged?
  - Acting as an agent of government
  - Exposure to risks and rewards
  - Non-market activity

When a development bank should be classified inside government?

- Three issues to be considered
  - Governance (control / decision-making autonomy)
  - Captive financial entity
  - Majority if the transactions is rearranged via government accounts

Rules for sector classification of development banks

- No special rules for development banks
- Applicable are, as for all other financial entities:
  - ESA 2010 chapter 2 on units and grouping of units
  - Manual on Government Deficit and Debt (MGDD) 2016:
    - Chapter I.5 on units engaged in financial activities
    - Chapter I.6 on specific public entities.
- The organisation of development banks vary significantly and therefore their statistical recording requires a detailed case-by-case analysis

When a development bank should be classified inside government?

- **Governance**, i.e. entity de facto has no autonomy of decision:
  - Government officials constitute the majority in a board of directors / management board
  - Government officials constitute the majority in key committees (or sub-committees) of the entity having a decisive role on key factors of its investment policy
- Development bank stops being a mean of government policy but simply executes operations on behalf of government

When a development bank should be classified inside government?

- If the DB meets the following three conditions, i.e.
  - it carries out a limited range of activities in narrow conditions in the framework of public policy objectives, <u>and</u>
  - government influence or constraints are evidenced simultaneously on its assets and liabilities, <u>and</u>
  - it does not behave like a 'normal' commercial entity (e.g. there is no expectation of a market rate of return on equity),

then the development bank is considered to have the characteristics of a captive financial institution and should be classified in the government sector.

When a development bank should be classified inside government?

- Assessing whether the DB carries out a limited range of activities in narrow conditions require the analyses of the governance structure
  - Where do the members of the committees come from and who delegates the members of the committees?
  - Tasks (lending, programme planning etc.) of the supervisory and management bodies and committees
  - Tasks of the bodies and committees with regard to day-to-day business (e.g. authority to issue directives, approval of transactions, certain institutions etc.)

When a development bank should be classified inside government?

- Assessing whether the DB carries out a limited range of activities in narrow conditions require the analyses of the governance structure
  - Under what procedures is the daily business conducted (who decides on the procedures, is approval necessary)
  - Are the investment activities restricted, i.e. beyond the restrictions made in the general mandate
  - Competition may be an argument but state aid usually require that the business is competition-neutral

When a development bank should be classified inside government?

- Constraints on the asset side mean that the parent imposes the conditions on the
  - nature of assets that the DB can hold
  - type and size of its interventions
  - the return on some assets (interest rates, fees, etc.)
  - characteristics of the beneficiaries of the activity
  - Need of ex-ante authorisation by the parent

When a development bank should be classified inside government?

- Constraints on the liability side mean that the parent imposes the conditions on the borrowing:
  - need of government authorisation
  - financing mainly provided by government
  - existence of government guarantees
  - possibility to take deposits from the public

When a development bank should be classified inside government?

- Shows the DB a behaviour like a 'normal' commercial entity:
  - Main source of income, use of the profit, distribution of the profit
  - Are there non-profitable operations (for what reasons are those operations carried out)
  - Are losses automatically covered by government
  - Does the DB try to work market-oriented (applying risk-based conditions even if the risk premiums may differ from commercial banks)?

When a development bank should be classified inside government?

- Majority of its transactions is ***rearranged*** via government accounts:
  - government is at the origin of the majority of its transactions, or
  - bank is entrusted by government to perform tasks which contribute to the implementation of specific government policies/interventions

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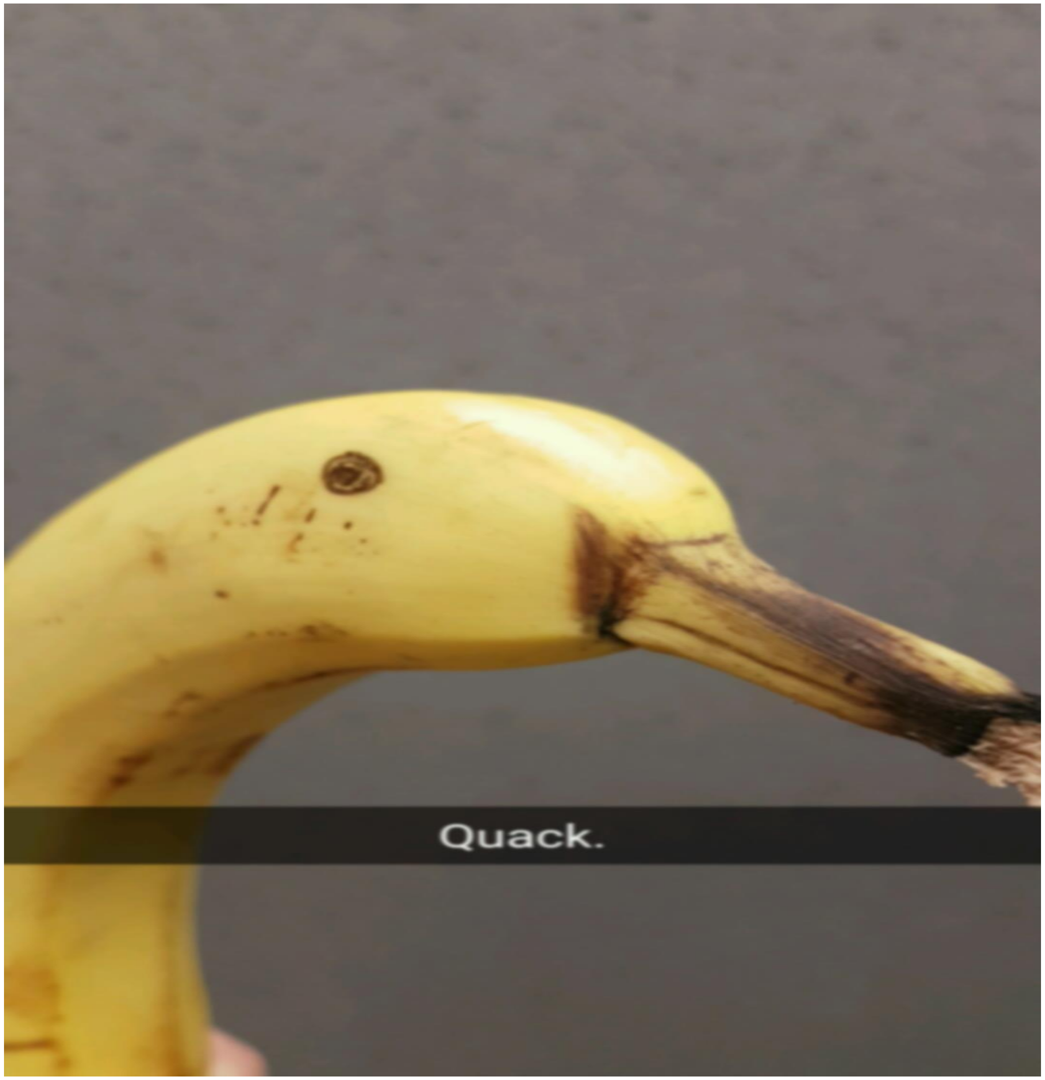
Thank you for your attention!

The duck problem

"If it looks like a duck, and quacks like a duck, we have at least to consider the possibility that we have a small aquatic bird of the family anatidae on our hands."

Douglas Adams
English Writer
(1952 – 2001)


Quack.