Guarantees

Coverage:

The table covers guarantees provided by general government institutions (S.13) with exception of social security funds (S.1314). Furthermore, data are reported in breakdown according to subsector – guarantees provided by central government institutions (subsector S.1311) and local government institutions (subsector S.1313). Data for subsector S.1311 are published for budgetary organizations, 6 state funds and other central government institutions. State semi-budgetary organizations, state public research institutions and public universities are not allowed to provide guarantees. Data for subsector S.1313 are compiled for local self-governing units (i.e. municipalities, regions, voluntary associations of municipalities, regional councils of cohesion regions) and public hospitals with legal form Inc., Ltd. and CIC. Local semi-budgetary organisations and public research institutions established by local self-governing units and voluntary associations of municipalities are not allowed to provide guarantees. Until 2017 data for public hospitals with legal form Inc., Ltd. and CIC are not available. Until 2013, data for local governments contain guarantees only for regions, capital city of Prague and cities Brno, Ostrava and Plzeň.

Data sources:

From 2018 (data for 2018 onwards), as a data source is used statement *Information on guarantees provided*, defined in Annex No. 2 to Decree No. 272/2017 Coll., on implementation of certain provisions of the law on the selected data collection for monitoring and management of public finances (Act No. 25/2017 Coll., as amended). According to this Act report data state funds, local self-governing units and public hospitals with legal form Inc., Ltd. and CIC. For 2014 – 2017 main data source were public accounts for institutions reporting according to Decree No. 410/2009 Coll. as amended (abolished by Decree No. 273/2017 Coll.). Data were reported in annex No. 5, the statement K – Auxiliary information on guarantees provided. Data had been obtained by individual surveys until 2013. For other units and for standardised guarantees the data are obtained from statistical surveys.

Period covered:

Yearly (years T-1, T-2, T-3 a T-4)

Publication:

T+10 months

Revision:

Data are revised.

Methodological description:

Guarantees provided only to units classified outside general government sector are reported. The stock of guaranteed debt liabilities is consolidated for the general government. Stocks of guaranteed debt do not include stocks of debt, which have already been assumed by government and recorded in ESA 2010 accounts.

Contingent liabilities from granted one-off and other guarantees mean guarantees or financial guarantees according to Civil Code, i.e. guarantees including a written statement provided by guarantor to the creditor to satisfy creditor's claim, if the borrower fails to meet his obligation payable to the creditor, and the creditor is entitled to require the fulfilment of the claim against the guarantor in the event that the debtor has failed to fulfil its obligation payable under the guarantee statement and guarantees arising from any statement in the

letter of guarantee to satisfy creditors up to a certain amount depending on the content of the letter of guarantee if a third person does not meet certain obligations or other conditions as set out in the letter of guarantee are met, also the **bill of exchange guarantee statement** ("směnečné rukojemství") attached to the bill of exchange or copy of promissory note **and guarantees provided by the Czech Republic on the basis of a special law**.

The data do not include government guarantees issued within the guarantee mechanism under EFSF, derivative-type guarantees (guarantee meets the definition of financial derivative), deposit insurance guarantees, guarantees issued by government on events which occurrence is very difficult to cover via commercial insurance.

One-off guarantee is defined as individual, and guarantors are not able to make a reliable estimate of the risk of calls. One-off guarantees are linked to debt instruments (e.g. loans, bonds).

Other guarantees are guarantees, which do not meet the definition of one-off guarantees.

The information published in the table includes the outstanding amount of guaranteed debt, not assumed by general government. The amount of guarantees provided to public corporations (sector S.11) and financial institutions (sector S.12) is also reported separately.

Presentation format:

(xlsx table)

Manual on Government Deficit and Debt - Implementation of ESA 2010 - Edition 2019

Presented part of MGDD is unofficial and only for informative purposes. The binding version is available on the website of the European Commission – Eurostat.

7.4 Government guarantees

7.4.1 Background

1. In many EU Member States, government, usually at central government level but also at state or local level, provides guarantees on the borrowing of certain corporations or other entities both in the public and in the private sector. The guarantee can be unconditional or conditional and government can act alone or jointly with other units. Generally this allows the beneficiary unit to borrow at a lower interest rate[257], and even in some cases this support is needed in order to have access to borrowing markets. There are different ways in which a guarantee may be exercised (realisation of guarantor's obligations). The most frequent case is generally when the guarantee call is activated by the creditor, for example a bank, often at first demand. Usually three parties are involved in such guarantee calls: the debtor, for example a public corporation, the creditor and the guarantor (in this chapter a government unit).
2. Government may also provide guarantees on assets held by some entities as part of their normal business or in the context of government policies. In this case, government takes the commitment to cover losses related to a decrease in the value of the assets or shortfalls in the recovery, with various ways of activating the guarantor's obligations. For guarantees on significant problematic assets, see chapter 4.5 Financial defeasance.
3. This chapter does not consider the following types of guarantees:
   - implicit government guarantees, as opposed to formal guarantees that are generally laid down in legal contracts (for instance in the case of guaranteed issuance of securities). Implicit guarantees may come from government's role as shareholder, or controller of the units, where it is considered that government will intervene in any case if problems are observed. Implicit guarantees may also relate to economic activity considered to be integral to the economy, where it is assumed that government will intervene to prevent a failure;
   - formal guarantee commitments, which are rather close to insurance schemes. For instance, government may 'guarantee' some payments by households (e.g. housing rentals) or grant guarantee for some specific events (e.g. art exhibitions).
4. Government may provide three kinds of guarantees:
   - in the form of derivatives (such as Credit Derivative Swaps), which fall under the normal treatment of derivatives and do not require specific provisions for such government transactions;
   - in the form of standardised guarantees (introduced in 2008 SNA and ESA 2010), see section 7.4.4 of this Manual;
   - in the form of 'one-off' guarantees, see section 7.4.2.
5. ESA 2010 paragraph 5.190 provides a definition of standardised guarantees which *…are issued in large number, usually for fairly small amount, among identical lines…*. Their main features are:
   - issued for the benefit of several financial institutions granting credits under a precise framework;
   - related to the assets of the benefiting financial institutions (the trigger of the guarantee due to the call does not come from a default of the lending unit on its own debt);
   - granted in the context of public interest policy.
6. Examples of standardised guarantees include those on student loans (notably where university tuition fees are high), real estate loans to households (generally for low-income borrowers) and export credit.[258]

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[257] This guarantee may result in a credit enhancement as rating agencies generally attribute to the debt of the borrowing unit the rating of the guarantor if higher.

[258] The term 'export credit' is used here in a narrow sense: guarantees on loans/credits to foreign purchasers, or loans to domestic suppliers, but excluding any form of insurance (such as prospection insurance, political risk, etc.). In other words, only a credit risk incurred by lending institutions is covered by the guarantee. Although listed in ESA 2010 and 2008 SNA as an example of standardised guarantees, within the EU, most export credit guarantees are instead considered as insurance. The operations referred to in this chapter are covered by the OECD 'Arrangement on Officially Supported Export Credits' (last update from July 2015).

7. In contrast to standardised guarantees, one-off guarantees are provided on a case-by-case approach, generally for rather significant amounts and under individual contractual arrangements. They are not offered under a general framework and imply a close follow-up by government on an individual basis and not globally. Frequently, they are subject to an examination of their impact by competition authorities.

8. ESA 2010 highlights another difference between standardised guarantees and one-off guarantees. In the first case guarantors should be in a position, when they offer a standardised guarantee, to estimate the average loss based on available statistics by using a probability-weighted risk of call. In the case of one-off guarantees, guarantors generally would not be able to make, at inception, a reliable estimate of the risk of calls as it is not predictable due to the uniqueness of the case.

9. In general, fees for one-off guarantees, received by government in its role of guarantor are classified as service fees, i.e., payments for non-market output (P.131). According to the accrual principle, this revenue should be spread over the life of the guarantee. Fees received by government in relation to standardised guarantees are equivalent to insurance premiums, notably under export credit schemes, and must therefore be treated similarly to the rules stated in ESA 2010 for non-life insurance (see ESA 2010, chapter 16).

10. However, in the case of specific one-off guarantees, the amount of fees received by government might be considered well out of proportion to the cost for government of providing the guarantee. In this case, the fee will have the nature of a compulsory payment (being out of proportion) and should be considered as unrequited. This means that in such cases a tax (D.29) would need to be recorded in accordance with ESA 2010 paragraph 4.23.

7.4.2 One-off guarantees

7.4.2.1 TREATMENT IN NATIONAL ACCOUNTS

7.4.2.1.1. General case

11. Generally, a government-guaranteed debt is recorded solely as the borrowing of the borrower and an asset for the lender, whether or not the guarantee concems specific borrowing (e.g. one particular loan) or the whole corporate debt. For government, it is a contingent liability which is not recorded in ESA balance-sheets (but may be shown as memorandum item or a footnote).

12. If the guarantee is called, whether for the full amount or for part of it, government takes over that part of the borrower's debt which was called, through a 'debt assumption' (see chapter 7.2), which is recorded as a capital transfer (D.99) from government to the borrower for the amount called. This has an impact on government net lending/borrowing (B.9). The capital transfer is matched by a financial transaction: the financial liability transferred from borrower to government. Government may, either immediately or subsequently, enter into a separate financial transaction when it repays the outstanding debt to the lender. This financial transaction has no impact on net lending/borrowing (B.9). This may also cover the interest accrued but not paid at the time of the assumption and which should have normally been added to the instrument.

13. In the public accounts balance sheet, the guaranteed debt may not be recorded until the guarantee is called (activated). However, it is expected that information on government

    guarantees is made publicly available. It is usually the case that Parliament approves a cap on the amount of guarantees government can grant over a fiscal year.

Partial calls

14. A 'partial call' of the guarantee (sometimes referred to as a 'cash call') occurs when government pays one instalment. The actual payment by government is recorded as a debt assumption: capital transfer (D.99) expenditure, balanced by a decrease in currency and deposit (F.2) (see sub-section 7.4.2.2.1 of the Manual and the decision tree at the end of this chapter). Conceptually, this is analysed as a debt assumption with government taking over part of the liability and as if there was a transfer of the financial liability to government that is followed by an immediate settlement of this amount in order to extinguish the liability. However, it may be the case that government is legally obliged to automatically assume all

the remaining debt (guarantees at first demand) as the result of an initial case. For cases of 'repeated calls', see the sub-section 7.4.2.1.3 of this Manual.

7.4.2.1.2. Case where government will repay the debt with certainty

15. In some cases, it is known with certainty that, despite the borrowing being legally carried out by the corporation, it will be government that repays the borrowing. This may occur for newly issued debt or for existing debt which government had started to guarantee.

16. In straightforward cases evidence is provided in legal documents or a government liability is recognised in the public accounts or in similar documents, e.g. the budgetary documentation. In such cases the debt is considered to be first issued by the corporation and then assumed by government. This assumption may happen immediately where it is obvious at inception that the debt will be assumed by government (i.e., it is imputed to government, in national accounts, from inception).

7.4.2.1.3. Case where it is judged that government repays or will repay the debt

17. In other cases, documented evidence may not be available to show that government has legally assumed the debt but other indicators might point to the fact that government has *de facto* assumed it. Evidence of such cases may include:

    - repeated calls: it is observed that government is repaying the debt each year[259], either directly (by calls, see below) or indirectly, through recurrent payments to the borrower, which allows the corporation to repay all or part of its debt obligations. Such payments[260] result in the provision to the unit of the means necessary to repay its creditors without formally activating the guarantee or avoiding a rollover of the debt (including by way of a financial advance from government). If such support becomes a common occurrence, it is considered a 'disguised' or indirect call,[261] which would trigger government assumption of the debt.

    - a provision has been recorded in public accounts or similar documents that show that the probability that government will repay the debt is very high and that it has already been recognised by government, beyond the usual prudential practice.

18. In these cases the outstanding amount of debt, or a relevant part of it, is treated in national accounts as assumed by government in the time period it is judged to have *de facto* assumed it.

19. Specific examples include e.g. situations when there are repeated calls on the guarantee (or where equivalent payments — like repeated capital injections — are made to the borrower to prevent a call being necessary). In the latter case, government effectively repays the debt even though it has no legal requirement to do so and does not formally record it as such in public accounts. In such specific cases, a case-by-case analysis is required.

20. As practical guidance, if government repayments of the debt occur over three consecutive calls what is referred to as the 'three calls rule' (see indirect calls above), then the debt is to be considered as having been automatically assumed by government. The debt would normally be assumed in its entirety; although this could be reduced to only the proportion government is expected to repay, if there is evidence of that. The debt assumption should be recorded at the time of the event triggering statistical decision to recognize the debt assumption, for example, the time of the third annual payment. The debt assumption is to be recorded as described in sub-section 7.4.2.1.1. When government has provided guarantees on several debt instruments issued by a single entity, the rule should apply on the basis of calls on any of the guaranteed liabilities during a given year (and is equivalent of a single call for that year). Therefore, in the event that a judgement is made that a debt will be assumed in its entirety, all government-guaranteed debt of that entity is assumed at the same time.

21. An exception is made when there are strong indications that the situation (i.e. defaulting) will not continue. This would mean that a fundamental restructuring of the borrowing unit benefiting from the

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[259] In some cases, several calls could be observed during the same year under the same guarantee arrangement. They are accounted for a single call in the implementation of the rule.

[260] Any transfer from government would be counted in this regard, except subsidies on products (D.31), but including other subsidies on product (D.319).

[261] In practice, it may be difficult to assess such indirect call because of the multiple sources of profits of the corporation and the possible variety of government support. Therefore, this provision would apply only if such situation would be observed continuously over several exercises and not exceptionally. The cases where government would systematically provide funds to the corporation for the payment of a large part of the interest burden should also be closely examined, as it might be an indication that the corporation would not be in able to redeem the principal of its debt. Anyway, on an individual approach, this should give rise to specific examination by national statisticians, in cooperation with Eurostat.

guarantee (hereby referred to as the borrower) has been decided and it can be assessed, from the business plan to be provided, that the entity would in the future be in a position to face its debt obligations.

7.4.2.1.4. Case where a claim on a third-party asset [262] is transferred to government

22. A guarantee on liability may be called, possibly at the initiative of the creditors, where the borrower cannot meet its debt obligations on time and not because of its problems with the underlying solvency. An example of this could be temporary liquidity difficulties. In some cases, such as export credit guarantees, a debt assumption may imply an automatic transfer of a claim on a third-party asset[263]. This may be also the case when the guaranteed borrowing is secured by specific assets (e.g. covered bonds[264]). In this case the market value of the asset transferred to government as foreseen in the guarantee arrangements[265] should be deducted from the capital transfer, provided that it is very likely that government will realise the value of the asset in the short term. If a market value is not available, a fair value may be estimated on the basis of usual business estimation methods/models carried out by an independent body. The part which is recognised as claim should follow the same treatment as in the next paragraph.

23. In the case of guarantees on financial assets, any call must be recorded as capital transfer expenditure of government. It may happen that the arrangement between the unit benefiting from the guarantee and government foresees that, under some conditions, the guaranteed assets could be transferred to government. This should be recorded in government accounts as reduction to a capital transfer expenditure for the full amount of the assets transferred, at the time of the transfer. When no recoveries are expected, the claim is not entered into government's balance sheet. Any unexpected recoveries are recorded as a capital transfer revenue of government. When there is a reliable estimate of the recoverable value, following normal business valuation methods by an independent body, the recoverable value should be deducted from the capital transfer and treated as the acquisition of a financial asset. The asset should enter government balance sheet and repayments by the debtors to government should be treated as financial transactions.[266]

24. Another possibility is that the asset acquired by government could be a non-financial asset rather than a financial claim, such as a real estate property. Here, in case of default, government assumes the guaranteed debt of the borrower and also takes the ownership of a given non-financial asset. The recording would be similar to the case mentioned in the paragraph 22 and the value of the transferred asset should be deducted from the capital transfer, and entirely off-set it, if the value of the asset is equal to the value of the debt assumption. There would be an impact on government net lending/borrowing (B.9) due to the capital formation recorded, but this would just substitute the impact on B.9 that the capital transfer would have had. When government immediately disposes of the asset, the final impact on government net lending/borrowing (B.9) will be neutral if government resells the asset for the value recorded at the time of the debt assumption.

7.4.2.1.5. Case where the assumption of a liability includes a claim on the guaranteed unit

25. When government assumes debt through a guarantee call it may also at the same time acquire a financial asset that is a claim on the guaranteed corporation, such as a claim — recognised in the public accounts — on any recoveries that it can subsequently make.

26. In most cases where government is judged to assume debt from a public corporation facing a difficult situation, it is considered that any new claim of government on the corporation, possibly recorded in public accounts, would be of uncertain value. In this case, the claim would not be recorded in

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[262] The case of guarantees on assets held by financial institutions in distress is covered in chapter 4.5 Financial defeasance.

[263] Third party means that the asset is not a claim of the guaranteed unit but on another unit, which is not part of the guarantee arrangement. In the cases of financial claims held by the guaranteed unit, such asset could be transferred (possibly due to contractual obligations) by the debtor to this unit (its default may have triggered the activation of the guarantee) and then retransferred to government. It would be de facto a claim on a 'fourth party'.

[264] Normally, the creditors have a direct right on these kinds of collaterals, which must be clearly identified (segregated) in the balance sheet of the borrower. However, this would not exclude that the creditors activate their guarantee right if the borrowing is also sublet to an explicit government guarantee.

[265] If such value is not observed, a fair value may be estimated by independent bodies, on the basis of usual business estimation methods/models.

[266] Under some conditions, part of the claim would not be recovered and should be treated as either capital transfer or other changes in the volume.

government's balance sheet. In case of later repayments from the public corporation, these would be recorded as capital transfer revenue of government to be super-dividend tested (see also below in sub-section 7.4.2.1.6). In the case the borrower would be fully private, it could be considered that government is holding a claim. However, in case the borrower shows accumulated or regular losses, and more particularly, a negative net equity, no claim on the unit should be recorded in national accounts.

7.4.2.1.6. Change of circumstances after a debt assumption

27. After government has been economically judged to assume debt it guaranteed (see sub-section 7.4.2.1.3), it may happen that the financial performance of the defaulting borrower improves to the extent that it resumes making regular debt repayments and can resume its legal obligations for the liability. Here, the previous economic assessment is no longer appropriate and the corporation is deemed to assume the debt back from government. This is recorded as a capital transfer from the corporation to government, offset by a financial transaction where the liability is transferred from government to the corporation[267].

28. When the recovering entity is a public corporation, the transaction recorded in favour of the government should be subject to the super-dividend test, part of the payment being partitioned as an equity withdrawal (F.5) for the amount in the excess of the distributable income, net of any dividend paid.

29. To avoid instability in government debt statistics, any debt imputed to government should remain as a liability of government until payments from the defaulting entity to government or to the creditor actually occur, and there is strong evidence that they will continue in the future. In other words, the improvement in the financial situation of the defaulting borrower must be viewed as permanent and not due to temporary factors.

7.4.2.1.7. On-lending

30. If government borrows on the market in its own name, but with the explicit purpose to specifically allocate the funds to corporations that are contractually obliged to repay government for both principal and interest, the debt is recorded as government debt at issuance and a corresponding loan is recorded to the corporation. The loan is analysed according to rules on capital injections in public corporations (see chapter 3.2. Capital injections into public corporations). Therefore, it may or may not have an impact on the government net lending/borrowing (B.9) according to the capital injection test.

31. Government may guarantee the borrowing of an entity, which then, under instructions from government, would finance corporations engaged in public sector infrastructure or other projects. If the entity is recognised as a separate institutional unit (see ESA 2010 paragraph 2.12), the borrowing should be rerouted, so that government is recording borrowing from and lending to this unit. However, more frequently, the entity would not be recognised as an institutional unit (e.g. when it appears to be just undertaking the role of a 'passing-through' entity), so the borrowing would be recorded in national accounts as direct government borrowing and lending to the infrastructure or other public projects.

7.4.2.2 RATIONALE OF THE TREATMENT

7.4.2.2.1. General case

32. The general principle is that guarantees are considered contingent assets/liabilities.

33. ESA 2010 paragraph 5.08 states *…as they do not give rise to unconditional obligations, contingent assets and liabilities are not financial assets and liabilities.*

34. As a result, contingent liabilities are not recorded in the ESA balance sheet and are excluded from government debt. Similarly, the granting of guarantees is not normally considered a transaction in national accounts. In the general case, the action of granting a guarantee would only lead to the recording of transactions for the fees and when the guarantee is activated, i.e., when the guarantor replaces an original borrower (or in some cases compensates the holder of some identified assets) due to a default that triggers the exercise of the guarantee. In some cases, a judgment must be made that the guarantee has effectively been activated despite not legally being fully activated. The exercise of the guarantee can lead to debt assumption and, in most cases, to capital transfers. In a debt assumption the

[267] In the case of guarantees on assets, except if there is a transfer of the assets to government, when the original beneficiary of the guaranteed unit can repay to government the amounts which have been already called and paid by government to the unit holding the assets, these payments are recorded in government accounts as a capital transfer receivable.

amount of capital transfer recorded is the payment obligation taken on the guarantor on behalf of the original borrower.

35. Any call of a guarantee, whether full or partial, is thus equivalent to a debt assumption by government.

7.4.2.2.2. Case where government will repay the debt with certainty

36. Government guaranteeing new debt where it is certain that government, as guarantor, will repay it, is economically equivalent to government borrowing directly from the creditor, as it has taken on the obligation to service the debt. In this case, the proceeds of government borrowing would then be used to fund the corporation but, as government would not expect to receive anything in return from the borrowing unit, this transaction would not be a loan and should be recorded as a distributive transaction, a capital transfer with an impact on government net lending/borrowing (B.9).

37. When government guarantees an existing debt and it is known with certainty that government will repay it, the treatment is similar to a debt assumption that benefits the guaranteed unit.

7.4.2.2.3. Case where it is judged that government repays or will repay the debt

38. This case is equivalent to an informal call of the guarantee. The recording reflects the concept of economic substance being recorded rather than legal features or administrative form (see ESA 2010 paragraph 1.25). In such cases, government is viewed as having assumed the debt from the corporation.

39. Cases where government makes debt repayments every year instead of the corporation, without any formal call of a guarantee, have been observed and must be carefully analysed to judge whether they are in effect a call on the guarantee. These payments are indications that, in practice, government is expected to assume the debt. Recording the liability as government debt is the result of judging the economic reality to be that government will continue to assume the liability on a regular basis, in which case the liability is economically considered to belong to government (and thus rerouted).

40. For the purpose of national accounts, economic reality must always prevail over legal form. An ambiguous situation where a further reclassification of the debt could occur in the future should be avoided.

7.4.2.2.4. Case where a claim on a third-party asset is transferred to government

41. When a guarantee is called, government may receive from the guaranteed unit an asset, e.g. in the form of equity or a loan. An assessment is needed whether this claim could be recognised in national accounts.

42. For example, if government receives a claim on a loss-making public corporation, what government receives would be considered as worthless as the corporation will not be able to pay it and hence no claim is recorded in national accounts.

43. If the claim (received by government) has been recorded in the public accounts as a loan to a private corporation[268], then the case needs to be analysed. Whenever the private corporation faces financial difficulties (accumulated losses, negative equity, no access to market), so that its real value should be zero or close to zero, such a claim would not be recognized in national accounts. Here, the option to record an equity injection (F.5) from government would generally be inappropriate[269]. The claim is not recognized and the transaction related to the activation of the guarantee would be recorded as a capital transfer.

7.4.2.2.5. Case where an assumption of a liability includes a claim on the guaranteed unit

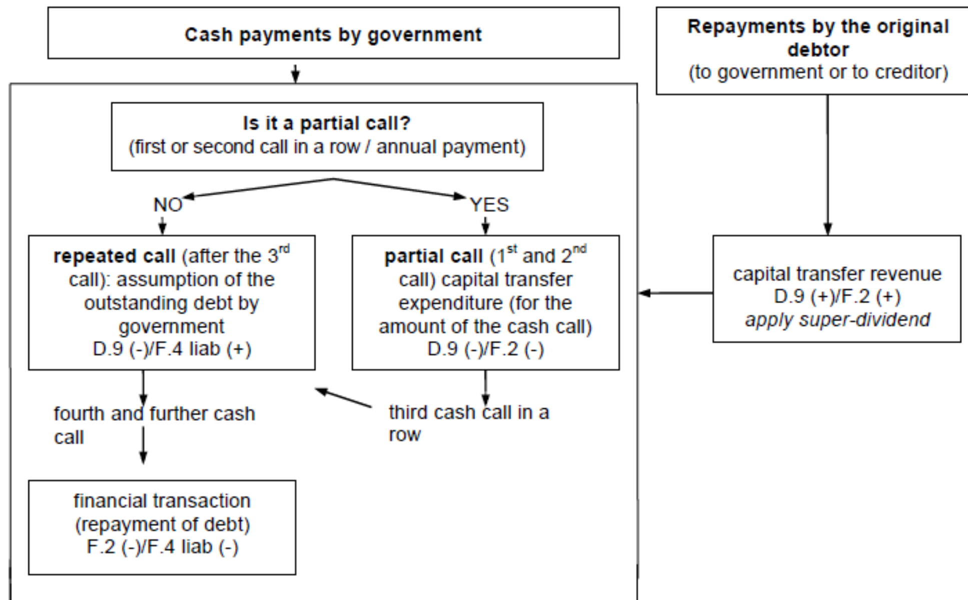
44. An issue also arises when a government guarantee is called and, in return, government records a claim towards the guaranteed unit. This claim is to be recorded in national accounts, off-setting the amount of capital transfer, only if it has a positive and certain value, i.e., when it may really be recognised as a claim in national accounts. The notion of 'recognized claim' is referred to in several commercial accounting texts (notably in IPSAS 19). If the value of the claim is uncertain and held towards a corporation that is in financial difficulties or loss-making, a capital transfer for the full amount called must

[268] For public corporations, the paragraph 25 above states that in any case no claim is recognised.

[269] It could be possible only if there would be a strong expectation to receive some amounts, the guarantor having access to the liquidation value of the company.

be recorded. Any amount later reimbursed by the guaranteed unit to government is recorded as a capital transfer revenue of government at the moment of reimbursement.

Decision tree for guarantee cash calls



7.4.3 Standardised guarantees

7.4.3.1 TREATMENT IN NATIONAL ACCOUNTS

7.4.3.1.1. General principle

45. In national accounts the treatment of standardised guarantees is based on the analogy with non-life insurance. The treatment is described in ESA 2010, chapter 16 Insurance (and in 2008 SNA chapter 17 Cross-cutting and other special issues).

46. The treatment of non-life insurance in national accounts is based on the assumption that the unit providing such standardised guarantees will be acting commercially, i.e., with the aim to make a profit. However, it might happen that the size of the premiums and/or the investment income would not cover an exceptionally high level of claims. In the EU, insurance activity is closely regulated by Supervision Authorities in order to prevent such situations[270]. However, granting only standardised guarantees is not as such considered a core insurance activity subject to the EU regulation and supervision.

47. Therefore it would not be totally unlikely that an EU government could grant standardised guarantees for commercial purposes, even if it is doubtful that it will compete with non-government units in this activity. As a matter of principle, if such guarantee activity may be profitable, it would rather be carried out only by non-government units. However, from a theoretical point of view, if this was observed, i.e., government charging fees deemed to be 'economically significant' covering most of the expected calls

(270) See Directive 2009/138/EC (Solvency II).

plus the administrative costs,[271] it would result in a treatment in national accounts similar to non-life insurance as mentioned above.

48. When government grants standardised guarantees an AF.66 liability is recorded in its balance sheet. It is equal to the present value of the expected calls under the guarantees, net of any recoveries that the guarantor could expect to receive from the defaulting borrowers[272]. In setting up such a liability there is some analogy with recording a provision in a business accounting framework (including IPSAS), which requires making reliable but prudent estimates on the basis of evidence such as past experience, or forecasts in case of a new activity.[273] As such, these expectations are not necessarily linked to the market (profitable) or non-market nature of this specific guarantee activity. If government charges fees under the conditions mentioned in previous paragraph (to cover for government of providing the guarantees), there will be an entry in the financial accounts equal to the fees received less the calls of existing guarantees. Therefore the counterpart of the liability is a cash payment (part of the fees retained to build up reserves and part of the revenue of investments not used to pay claims).[274]

49. If government charges no fees or at a level far from covering the total costs of the scheme for government[275], the counterpart of the incurrence of this liability is not a flow of cash but is a non-financial transaction, i.e., a transfer from government..

7.4.3.1.2. Recording a special liability in the case of non-commercial activity

50. From a practical point of view, each time a principal amount of loans (covering multiple debtors) granted by financial institutions and covered by a government standardised guarantee scheme during a given period, a certain percentage would be recorded as an AF.66 liability in government's balance sheet, with a capital transfer as counterpart for the AF.66 liability amount net of any fees collected.[276] In national accounts this capital transfer benefits the policy holders (thus holders of the AF.66 asset), i.e., the financial institutions which grant the loans and have a contractual recourse to the guarantor government, rather than the borrowers. Of course borrowers benefit from the existence of the guarantee scheme organised by government for them but they are not the main economic beneficiaries. The capital transfer may be analysed as an anticipation of the net cost of the expected calls. Because of their assumed likelihood, there is conceptually an impact at inception in government accounts as, by definition, government is expected to lose money in the scheme.

51. When a call on a guarantee is made and paid, there is no impact on government net lending/ borrowing (B.9). The provision AF.66 could be equal to the full amount of a loan (such a 100 % risked loan would never be granted) and may be re-adjusted. It seems useful to keep the information on the total amount of loans (or other assets) that are covered by a government standardised guarantee, similarly to the case of one-off guarantees.

52. The recording of the liability AF.66 is, in 2008 SNA paragraph 17.223, conditional on recognition of a provision in the own accounts of the government units (based on an accounting framework different from national accounts). National accountants should record this liability on the basis of the estimates made by government. As a principle, national accountants should not diverge from this estimate, as it is doubtful that they could themselves be in a better position to make reliable estimates of expected losses. It must also be pointed out that, under public accounting rules such as IPSAS or equivalent, which are increasingly being adopted by government units, the setting up of adequate provisions for any

[271] Note that, in this case, the government unit engaged in this activity could be considered a financial quasi-corporation (under the conditions set up in ESA 2010 chapter 2 (Units and grouping of units) and in Part 1 of this Manual (Delimitation of the general government sector), and thus classified outside government sector, so that only flows between this unit and government would appear in government accounts.

[272] This refers to the possible late repayments that a debtor could make after the guarantee had been called. The debtor may be still legally committed but, in many cases, for various reasons, its debt may be irremediably considered fully unrecoverable after the activation of the guarantee.

[273] Note that in 2008 SNA and ESA 2010 it is called 'provisions for calls under standardised guarantees' but it must be stressed that it is not similar to provisions in Business accounting which are recorded only in the accounts of the unit setting up the provisions whereas, in national accounts, it is considered a financial instrument and thus recorded both as liability (in guarantor accounts) and reciprocally as asset (in the accounts of policy holders).

[274] It may be 're-adjusted' by other change in the volume when the expectations of claims (calls) on the entire risk portfolio are re-estimated upwards or downwards.

[275] This situation is considered in 2008 SNA (see paragraph 17.223) rather than in ESA 2010.

[276] It is recorded as a capital transfer, and not a current transfer, because the AF.66 provision is built up for the future defaults (and not defaults observed during the current year) and represents the anticipation of call of guarantees following debtors' defaults, which, under ESA 2010, are recorded as capital transfer (see ESA 2010 paragraph 4.165 (f)).

risky activity is a strong requirement, provided that it is possible to make reliable estimates of the impact of the risk.[277]

53. However, not all governments have adopted in their public accounts (and this is specifically relevant if one considers all sub-levels of the general government sector) accounting framework which impose to record provision for future risks. One could expect that EU Member States where central government would directly grant standardised guarantees would have such framework. Where it is not the case, for comparability reasons, national accountants should consider whether they have sufficient elements, such as similar schemes in other Member States, in order to estimate the AF.66 liability, after discussing with Eurostat. However, totally new schemes, with very specific features, might raise some difficulties.

54. The liability could be revised upward in case the risk of default would be further estimated higher and, by consistency with the treatment at inception, a new capital transfer would be recorded under similar conditions, if it assumed that this would be observed for all existing loans portfolio and not only for the new loans which could show a specific default rate. Under another case, the risk could be lower than expected and the liability could be downward adjusted, first by an imputation on the capital transfer related to new operations in the year and, for any excess, by a reverse capital transfer. However, Eurostat recommends that the downward adjustment should take place only when the improvement in the recovery of the claim is observed over a rather long period and is considered to be quite irreversible. It might also happen that government would have to face guarantee calls higher than the 'provisions' set in advance at the time the loans were granted. This should be recorded as a new capital transfer. Government will have also in this case to reconstitute the provision for the remaining portfolio of loans under a new capital transfer.

7.4.3.2 RATIONALE OF THE TREATMENT

55. The reasons why such guarantees should be treated in national accounts similarly to non-life insurance are given in ESA 2010 (see ESA 2010 paragraph 5.190 and following) and in 2008 SNA (chapter 17 Cross-cutting and other special issues, Part 3: The treatment of standardizes guarantees in the SNA). The small individual amounts covered by the guarantees and the repetition of similar features a large number of times, explains the focus on the global treatment of the total guaranteed amount rather than the individual level, which is not managed directly by the guarantor. The purpose of such government standardised guarantees is generally to implement a public interest policy for a large number of potential beneficiaries, while, generally, one-off guarantees are linked to the specific situation of individual entities or small groups of units.

56. ESA 2010 paragraph 5.192 explains that standardised guarantees are usually provided by financial corporations in S.12 but can also be granted by government. The former are provided on a commercial basis. The methodology was created to work similarly to non-life insurance. Government involvement will be for public policy reasons rather than on a commercial basis. The ESA category is adopted for all sectors of the economy, with some adaptation of the recording for government due to its non-market nature.

57. In the case of government's standardised guarantees, fees paid by the beneficiaries are often not fixed in order to cover all or almost all costs of the scheme, as mentioned in 2008 SNA paragraph 17.223. Government does not aim for a neutral impact on its income statement by fixing the fees at a level where, on a time-equivalence perspective, they should cover most, if not all, the expected defaults on the underlying assets by its own resources. Government intervention through standardised guarantees schemes takes place in the context of policies of which the objective is to improve market access for some specific categories of economic agents. In this regard, one can expect an unrequited transaction element behind such arrangements.

7.4.4 Accounting examples

One-off guarantees: rule of 3 successive calls

Government grants a guarantee of 100 to a public corporation for a debt under the form of loan AF.4 (no fee charged by government).

[277] Usually this depends on two parameters: 'Probability of default' and 'Loss given default'. However, it may happen that auditors would not request for provisioning, in case the impact is deemed rather negligible for the unit and if the uncertain time of the possible future impact would rather take place in a distant future.

1) At inception, there is no reason to consider that the guarantee will be automatically called. There is thus no record in government accounts. The guarantee is a contingent asset (by simplification, interests on the debt are not shown in the example).

General government

Financial account

ΔA		ΔL	

Closing balance sheet

A		L	

Public corporation

Financial account

ΔA		ΔL	
F.2	+100	F.4	+100

Closing balance sheet

A		L	
AF.2	100	AF.4	100

2) In year *t*, there is a call of the guarantee for 10. It is similar in year t+2 (while in t+1 no guarantee is called).

General government

Opening balance sheet

A		L	

Non-financial account

U/ΔA		R/ΔL	
		D.9	-10
B.9	–10		

Financial account

ΔA		ΔL	
F.2	+10–10	F.3	+10
		B.9	–10

Closing balance sheet

A		L	
		AF.3	10

Public corporation

Opening balance sheet

A		L	
		AF.4	100

Non-financial account

U/ΔA		R/ΔL	
		D.9	10
B.9	+10		

Financial account

ΔA		ΔL	
F.2	+10-10	F.4	–10
		B.9F	+10

Closing balance sheet

A		L	
		AF.4	90

3) In year t+3, there is a third call of guarantee for the remaining part 80. Government issues debt securities of 10 and a loan of 70 to cover this call.

General government				Public corporation			
Opening balance sheet				**Opening balance sheet**			
A			L	A			L
		AF.3	20			AF.4	80

General government				Public corporation			
Non-financial account				**Non-financial account**			
U/ΔA			R/ΔL	U/ΔA			R/ΔL
		D.9	–80			D.9	80
B.9	–80			B.9	+80		
Financial account				**Financial account**			
ΔA			ΔL	ΔA			ΔL
F.2	+80–80	F.3	+10	F.2	+80-80	F.4	–80
		F.4	+70				
		B.9F	–80			B.9F	+80
Closing balance sheet				**Closing balance sheet**			
A			L	A			L
		AF.3	30				
		AF.4	70				

Reclassification as government debt at inception

Government grants a guarantee of 100 to a public corporation for a debt under the form of bullet bonds (AF.3), no fee charged by government.

1) At inception, there is strong evidence (corporation with negative own funds, repayment commitment taken by government, etc.) that the debt would be repaid by government. The debt is thus considered at inception as government debt (by simplification, interest on the debt are not shown in the example).

General government				Public corporation			
Non-financial account				**Non-financial account**			
U/ΔA			R/ΔL	U/ΔA			R/ΔL
		D.9	–100			D.9	100
B.9	–100			B.9	+100		

General government				Public corporation			
Financial account				**Financial account**			
ΔA			ΔL	ΔA			ΔL
		F.3	+100	F.2	+100	F.3	+100–100
		B.9F	–100			B.9F	+100

Closing balance sheet			
A			L
		AF.3	100

Closing balance sheet			
A			L
AF.2	100		

2) At final maturity, the public corporation is in a position to repay by itself 10 out of a principal repayment of 100.

General government | **Public corporation**

Opening balance sheet (General government)			
A			L
AF.2	90	AF.3	100

Opening balance sheet (Public corporation)			
A			L
AF.2	10		

Non-financial account (General government)			
U/ΔA			R/ΔL
		D.9	10
B.9	+10		

Non-financial account (Public corporation)			
U/ΔA			R/ΔL
		D.9	–10
B.9	–10		

Financial account (General government)			
ΔA			ΔL
F.2	+10–100	F.3	–100
		B.9F	+10

Financial account (Public corporation)			
ΔA			ΔL
F.2	–10		
		B.9F	–10

Closing balance sheet (General government)			
A			L
		AF.3	0

Closing balance sheet (Public corporation)			
A			L

Government guarantee on losses related to problematic assets[278]

1) In year *t*, for a nominal value of problematic assets of 100, losses on these assets are reliably estimated at 70. The guaranteed amount is recorded as government expenditure (D.9) and a liability (F.8) of government. Problematic assets remain in the accounts of the financial institution.

General government | **Financial institution**

Opening balance sheet (General government)			
A			L

Opening balance sheet (Financial institution)			
A			L
AF.3	100	AF.3	100

Non-financial account (General government)			
U/ΔA			R/ΔL
		D.9	-70
B.9	–70		

Non-financial account (Financial institution)			
U/ΔA			R/ΔL
		D.9	70
B.9	+70		

[278] See chapter 4.5 Financial defeasance for the definition of the problematic assets.

Financial account (General government)

ΔA		ΔL	
		F.8	+70
		B.9F	–70

Financial account (Financial institution)

ΔA		ΔL	
F.8	+70		
		B.9F	+70

Revaluation account (General government)

ΔA		ΔL	

Revaluation account (Financial institution)

ΔA		ΔL	
AF.3	–70		

Closing balance sheet (General government)

A		L	
		AF.8	70

Closing balance sheet (Financial institution)

A		L	
AF.3	30	AF.3	100
AF.8	70		

2) In year t+1, government transfers cash to the financial institution, which has to repay 70 on its debt. Government needs to borrow on markets.

General government

Opening balance sheet

A		L	
		AF.8	70

Financial account

ΔA		ΔL	
F.2	(+70-70)	F.8	–70
		F.3	+70
		B.9F	0

Closing balance sheet

A		L	
		AF.3	70

Financial institution

Opening balance sheet

A		L	
AF.3	30	AF.3	100
AF.8	70		

Financial account

ΔA		ΔL	
F.2	(+70–70)	F.3	–70
F.8	–70		
		B.9F	0

Closing balance sheet

A		L	
AF.3	30	AF.3	30

3) Alternative: in year t+1: the financial institution has to redeem its debt for 70. The problematic assets are sold for 40, so the realised loss on the assets is 60 (instead of the earlier estimate of 70). Cash amount is transferred by government (from borrowing on markets).

General government

Opening balance sheet

A		L	
		AF.8	70

Financial institution

Opening balance sheet

A		L	
AF.2	0	AF.3	100
AF.3	30		
AF.8	70		

Non-financial account

U/ΔA		R/ΔL	
		D.9	+10
B.9	+10		

Non-financial account

U/ΔA		R/ΔL	
		D.9	–10
B.9	–10		

Financial account

ΔA		ΔL	
F.2	(+60–60)	F.8	–60–10
		F.3	+60
		B.9F	+10

Financial account

ΔA		ΔL	
F.2	+60+40–70	F.3	–70
F.8	–60–10		
F.3	–40		
		B.9F	–10

Revaluation account

ΔA		ΔL	

Revaluation account

ΔA		ΔL	
AF.3	+10		

Closing balance sheet

A		L	
		AF.3	60

Closing balance sheet

A		L	
AF.2	30		
AF.3	0	AF.3	30

Standardised guarantees: case with no fees charges by government

Government grants a guarantee to loans granted by some financial institutions (no fee charged by government — government is not acting on a commercial basis and, should fees be perceived, they would at best cover only administrative costs).

At inception of the loans, government set up a liability (provisions for calls under standardised guarantees (AF.66)) on the basis of an estimated expectation that 20 % of the loans will result in a cost of 20 for government for any granted amount of 100 (for simplification, the costs of production of such guarantee are here considered nil).

General government

Opening balance sheet

A		L	

Non-financial account

U/ΔA		R/ΔL	
		D.9	–20
B.9	–20		

Financial institution

Opening balance sheet

A		L	
AF.2	100		

Non-financial account

UΔ/A		R/ΔL	
		D.9	20
B.9	+20		

General government				Financial institution			

Financial account

ΔA			ΔL	ΔA			ΔL
		F.66	+20	F.2	–100		
				F.4	+100		
				F.66	+20		
		B.9F	–20			B.9F	+20

Closing balance sheet

A			L	A			L
		AF.66	20	AF.66	20		
				AF.4	100		

In year *t*, there is a call of guarantee due to debtor default (here of 20); government issues bond for the needed cash

General government				Financial institution			

Opening balance sheet

A			L	A			L
		AF.66	20	AF.66	20		
				AF.4	100		
				AF.2	0		

Non-financial account

U/ΔA			R/ΔL	U/ΔA			R/ΔL

Financial account

ΔA			ΔL	ΔA			ΔL
F.2	+20–20	F.66	–20	F.2	+20		
		F.3	+20	F.66	–20		
		B.9F	0			B.9F	0

Other changes in volume of assets account

ΔA			ΔL	ΔA			ΔL
				AF.4	–20		

Closing balance sheet

A			L	A			L
		F.3	20	AF.4	80		
				AF.2	20		