Fiscal policy audit report

Contingent liabilities of general government

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Fiscal policy audit report of the National Audit Office

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The National Audit Office has conducted an audit of the contingent liabilities of general government, which is included in its audit plan. The audit was carried out in accordance with the fiscal policy audit guidelines issued by the National Audit Office.

On the basis of the audit, the National Audit Office has issued an audit report, which will be submitted to the Ministry of Finance, Ministry of Economic Affairs and Employment, Ministry of the Environment, the Housing Finance and Development Centre of Finland, Finnvera Plc and to the State Treasury. Copies of the report will also be submitted to the Parliamentary Audit Committee and the Government Financial Controller's Function for their information.

Before the issuing of the audit report, the Ministry of Finance, Ministry of Economic Affairs and Employment, Ministry of the Environment, the Housing Finance and Development Centre of Finland, Finnvera Plc and the State Treasury were provided with an opportunity to ensure that there are no factual errors in the report and to give their views of the opinions of the National Audit Office contained in the report.

In the audit follow-up, the National Audit Office will examine which measures have been taken on the basis of the opinions presented in the audit report. The follow-up will take place in 2020.

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Conclusions

For the formulation of fiscal policy and steering of general government finances, it is important that the decision-makers have access to all essential information about the financial risks related to contingent liabilities of general government. Contingent liabilities include government guarantees, which may result in government expenditure in certain situations. Sustainable management of general government finances requires that all contingent liabilities are identified, the related risks are assessed, and the possible long-term impacts on the general government balance are taken into consideration. In connection with the updating of its assessment of the state of Finnish government finances and Finland's compliance with fiscal policy rules in May 2017, the European Commission drew attention to the amount of guarantees provided by Finnish general government.

The purpose of the audit was to assess the management of the increasing number of contingent liabilities of general government and the related preconditions. The main question of the audit concerned whether the management of contingent liabilities of general government is adequately taken into account in the formulation and steering of fiscal policy.

According to the findings, the management of contingent liabilities of general government has not been sufficiently taken into account in the formulation and steering of fiscal policy. The Finnish national fiscal policy rules do not in any way restrict growth in contingent liabilities. The EU has expanded the obligation to report contingent liabilities, but no limits have been set for growth in liabilities. The current status of sustainable financial management cannot be considered adequate in all respects, because no comprehensive calculations regarding the possible impacts on expenditure resulting from the realisation of risks have been presented. Furthermore, the level of risk appetite has not been determined at central government level. Risk assessments are carried out at the level of individual agencies, and no minimum requirements have been specified regarding the contents of the risk assessments.

The EU has expanded the obligation to report contingent liabilities, but no limits have been set for growth in liabilities

The state of the general government finances of the EU Member States is monitored at the EU level in accordance with the rules of the Stability and Growth Pact. The EU has reacted to the strong growth in contingent liabilities and its potential impact on budgets of Member States by expanding the reporting requirements applied to contingent liabilities. However, the EU rules do not contain any specific restrictions concerning growth in contingent liabilities, or any requirements to take related impacts into account in the formulation of the budgetary framework. Furthermore, Member States are not required to produce any comprehensive data on their risks related to liabilities or on the related impacts on their capability to manage potential payment obligations related to such liabilities.

In Finland, contingent liabilities are not reported in the national Stability Programme fully in compliance with the EU rules. The reporting only covers data concerning the central government, and significant liabilities in the local government sector are not appropriately taken into account. The data required by the Budgetary Frameworks Directive are published on the website of the Ministry of Finance.

National fiscal policy rules do not limit growth in guarantees

The spending limits rule laid out in the Government Programme and the central government spending limits are an essential part of Finland's national fiscal policy framework. However, neither of these contain provisions restricting growth in contingent liabilities. Furthermore, expenditure resulting from contingent liabilities is not adequately taken into consideration in the state budget. Consequently, the budget neither contains any restrictions regarding liabilities.

The reporting concerning contingent liabilities has improved overall, but the assessment of the impacts of related risks should be enhanced

Over the recent years, the coverage of liabilities has been expanded in the Government's annual report and the final central government accounts. Furthermore, since 2015, the Ministry of Finance has prepared an annual overview of the central government's financial risks and liabilities. The correctness of the related data has been further supported by the allocating the central responsibility for the compilation and reporting of data on guarantees to the State Treasury.

However, the data available about the impacts of contingent liabilities on the developments in central government finances and sustainability of financial management are not adequate in all respects. The magnitude of risks related to contingent liabilities remains partly vague, because no extensive scenarios regarding the possible impacts of expenditure resulting from the realisation of risks have been presented, and because the data on incurred losses are insufficient. Some data intended for publication are not actively communicated or utilised in the drafting of the Government's annual report or risk overview.

The knowledge base of the decision-making process could be enhanced by clarifying the content requirements concerning economic impact assessments

The guidelines for assessing the impact of legislative proposals describe different methods to carry out a comprehensive assessment of expenditure and risks. However, no separate decision has been taken on the minimum data requirements for the decision-making process. According to the audit, economic impact assessments carried out for decisions to increase authorisations vary in content and occasionally provide an insufficient picture of the related risk scenarios and foreseeable costs. In central government, the management of risks concerning contingent liabilities and the related decision-making have been decentralized to different units. The risk assessment procedure has not been harmonised, and each body can determine the contents of the risk assessment itself.

Contents of the risk reporting by Finnvera to its owners have not been specified, and the financial supervision of Finnvera is not appropriately organised

The content requirements concerning the ownership control and risk reporting by Finnvera have not been separately specified. The liability of the state concerning Finnvera changed from indirect to direct in 2005. At the time, it was considered that the owner control and industrial policy control of the state over Finnvera and the related reporting should be enhanced and developed to improve the state's risk management process.

However, the Internal Audit Unit of the Ministry of Economic Affairs and Employment does not have in place an up-to-date plan concerning the contents of its control activities. In practice, the control has been limited to reviewing the reports submitted by Finnvera and to arranging individual meetings and audit visits. The lack of planning regarding the control, and the fact that the principles to be applied have not been specified, have hindered the statutory control. In January 2018, the Ministry of Economic Affairs and Employment decided on the rules that the Ministry will apply to its financial supervision of Finnvera Plc in the future.

Recommendations of the National Audit Office

As the amount of contingent liabilities increases, the potential realisation of the related risks should be better taken into account in the formulation and monitoring of the sustainable management of general government finances. Recommendations of the National Audit Office:

1. Risk limits for contingent liabilities resulting from government subsidisation activities should be specified on the basis of an overall assessment of risks.
2. The Ministry of Finance should promote the creation of content requirements to be applied in the drafting of guarantee decisions and decisions to increase authorisations so that the financial impacts of such commitments are appropriately taken into account.
3. The Ministry of Finance should clarify the risk reporting requirements concerning the Government's annual report and the risk overview. The risk overview could be more clearly focused on the analysis of risks and related developments, as well as on the description of different risk scenarios.
4. The Ministry of Economic Affairs and Employment should specify the content requirements applied to the risk reporting concerning Finnvera and should ensure that the supervision of Finnvera complies with the legislative objective of supervision in accordance with the principles governing the supervision of credit institutions.

Contents

1 Scope of the audit

Audit objective and the audit questions

The purpose of the audit was to assess the management of the growing portfolio of general government contingent liabilities and to evaluate the capability of general government to manage them. The main question of the audit was whether the management of general government contingent liabilities is sufficiently taken into account in the drafting and steering of fiscal policy. The audit question was examined with the help of the following sub-questions:

1. Does fiscal policy steering contain elements the aim of which is to regulate the growth in contingent liabilities?
2. Is the picture given of the contingent liabilities true and fair?
3. Are the risks arising to central government from the contingent liabilities properly assessed?

Main audit criteria and scope of the audit

The requirements for the information content of the planning, decision-making and reporting concerning contingent liabilities laid down in the European Union law, national legislation and other guidelines and regulations were used as the audit criteria. The auditors compared the information presented in the planning, decision-making and reporting documents with the information content requirements laid out for the documents. They also compared the information presented in different documents with each other so that they could assess the reliability of the information base and detect any deviations.

General government fiscal planning and steering at national level and EU-level fiscal policy rules with their reporting requirements apply to general government as a whole. General government comprises[1] central government, local government and social security funds. When seeking answers to the first and second sub-questions of the audit, the auditors examined general government as a whole. In other areas, the focus was on central government level. The practices applied to the assessment of risks arising from the liabilities of local government and the social security funds were not evaluated in the audit.

Ministry of Finance, Ministry of Economic Affairs and Employment, Ministry of the Environment, the Housing Finance and Development Centre of Finland, Finnvera Plc and the State Treasury were the entities reviewed in the audit. With regard to risk assessment procedures, it was decided to select the two units managing the largest liabilities in terms of their nominal value for a more detailed review in sub-question three: Finnvera Plc and the Housing Finance and Development Centre of Finland (ARA). As to Finnvera Plc, the focus was on the guarantees granted as part of export financing. In ARA, the focus was on the guarantee and subsidised loans granted from the National Housing Fund. In this audit, these liabilities are considered as contingent liabilities arising from government subsidisation activities.

Economic significance

Government guarantees account for a large proportion of all contingent liabilities. The nominal value of all government guarantees totalled EUR 46 billion at the end of 2016 (Table 1). Even though the guarantees have not generated substantial losses in recent years, the risk nevertheless exists. The substantial export guarantee portfolio in particular may expose central government to major losses: between 1983 and 1996, export guarantees generated cumulative losses of about EUR 800 million and as a result, a cumulative surplus was not achieved until 2005. When financing costs are included in the total, the loss was about one billion euros.[2]

Table 1: Government guarantees between 2014 and 2016, EUR billion[3]

	2014	2015	2016
Finnvera	17.46	22.64	22.60
Total liabilities arising from export and special guarantees	12.60	16.28	15.3
Domestic liabilities	2.32	2.25	2.23
Government guarantees for loans	2.55	3.94	4.85
Student loans	1.77	2.01	2.33
EFSF (European Financial Stability Facility)	6.61	6.23	6.28
Bank of Finland	7.92	0.46	0.61
Government funds	11.84	12.31	13.10
National Housing Fund	11.80	12.26	13.06
Development Fund of Agriculture and Forestry	0.03	0.04	0.04
State Guarantee Fund	0.00	0.00	0.00
Other	0.34	0.59	1.05
Total	38.62	44.24	45.97

In comparisons between EU Member States, the guarantees provided by Finland's general government entities amounted to about 28 per cent of the GDP in 2015. Debts of public corporations outside general government are considered as implicit contingent liabilities, as laid down in the Budgetary Frameworks Directive. According to Eurostat, these liabilities totalled about EUR 90 billion[3] in Finland at the end of 2015 (Table 2).

Table 2: Debts of public corporations (outside general government)

	2013	2014	2015
EUR million	72,399	77,515	90,311
Per cent of GDP	35.96	37.80	43.18

Contingent liabilities

Contingent liabilities can be defined in at least three different ways:

1. in accordance with International Accounting Standards (IAS 37 and IPSAS 19)
2. based on national accounts (ESA 2010, 5.08–5.11)
3. from the macroeconomic perspective.

The macroeconomic perspective also covers implicit contingent liabilities. The amount of the liabilities of central government or the public sector also depends on what is meant by central government, public sector and liabilities.

General government: central government, local government and social security funds

In the European Union, deficit and debt statistics are based on the national accounts compiled in accordance with ESA 2010 and in the sectoral classification used in the system. In this classification, the public sector is referred to as general government.[5]

Under the national accounts, general government comprises

- central government (on-budget entities and other central government units)
- local government (municipalities, joint municipal authorities, Provincial Government of Åland and other local government units)
- social security funds (employment pension institutions and other social security funds)

Division of liabilities

The liabilities can be divided into categories, depending on their basis and realisation (Figure 1).

Basis of the liabilities	Realisation of liability: Direct liabilities: These are based on events that do not involve any material uncertainties	Realisation of liability: Contingent liabilities: The realisation of an event is conditional on the realisation of another event
Explicit	– central government debt – interest on central government debt – state budget expenditure (for the current fiscal year + the expenditure to which a statutory commitment of more than one year has been made) – other contractual liabilities	– Government guarantees – export financing liabilities (government export guarantees, interest equalisation and credits, compensating credit losses and guarantee losses arising from SME financing) – on demand capital contributions in international financial institutions
Implicit	– future pensions (if not on a statutory basis) – social security system (if not on a statutory basis) – financing of the future health care system (if not on a statutory basis) – future expenditure arising from public sector investments	– deposit guarantee – other support to the banking sector – state-owned companies (increase of share capital to retain ownership share or to secure operational capability) – debts of public corporations

Figure 1: Central government risks (adapted from Polackova 1998[6], Ministry of Finance 2015[7])

Explicit contingent liabilities include government guarantees. A situation where the government is expected to support the banking system in a crisis affecting the financial system can be considered an implicit contingent liability. The main difference between the above liabilities concerns the degree of commitment to the contingent liability. When the government liability is clearly based on legislation or an agreement, it is a question of an explicit contingent liability. An implicit contingent liability on the other hand concerns an obligation arising from political pressures or citizens' expectations: the government is expected to assume the ultimate responsibility for the obligations. An implicit liability can also be made into an explicit liability. For example, the government can state the maximum amount covered by the deposit guarantee.

2 Is fiscal policy steering used to regulate the growth in contingent liabilities?

The spending limits rule laid out in the Government Programme and central government spending limits set out in Finland's national fiscal policy rules do not contain elements that would limit the growth in contingent liabilities.

The European Union has made the coordination of fiscal policy more effective by including additional reporting obligations concerning contingent liabilities in the preventive and corrective arms of the Stability and Growth Pact. The Budgetary Frameworks Directive is the key instrument regulating the reporting on and publication of contingent liabilities. No targets or limits have been set for the total amount of contingent liabilities, however. Furthermore, considering the impacts of contingent liabilities in the budgetary framework has not been set as a requirement (in other words, no consideration is given to any payment obligations connected with contingent liabilities).

2.1 No limits have been set to the growth in contingent liabilities

Fiscal policy rules do not contain any factors limiting the growth in contingent liabilities (Table 3).

Table 3: Legislative basis for fiscal policy rules

Regulation, guidelines	Requirement to present information	Does it contain a limit to the growth in contingent liabilities (yes/no)
Central government spending limits and the spending limits rule set out in the Government Programme	On-budget expenditure	No
Preventive arm of the Stability and Growth Pact	Indirect liabilities arising from the ageing of the population and contingent liabilities, such as public guarantees, that may have a major impact on general government fiscal position must be detailed in the stability programme.	No
Corrective arm of the Stability and Growth Pact	When preparing the report required under the Treaties, the European Commission will take into consideration all relevant factors, to the extent that they have a major impact on the assessments of compliance with the deficit and debt criteria in the Member State in question.	No
Budgetary Frameworks Directive	Member States must publish relevant information on contingent liabilities with potentially large impacts on public budgets.	No
Regulation 473/2013	Euro area member states must submit to the European Commission their draft budgetary plans for the forthcoming year by 15 October.	No
Regulation 473/2013	Separate reporting requirements, until the abrogation of the excessive deficit procedure.	No
Fiscal Policy Act (869/2012)	Under the act, the Government has issued a decree on General Government Fiscal Plan (120/2014). The act contains provisions on the setting of the medium-term objective for general government fiscal position.	No

For many years, the focus in the fiscal policy rules of the EU has been on the general government deficits and debt targets and their monitoring. With the six-pack and two-pack legislative packages, the European Union added new reporting obligations concerning contingent liabilities to the preventive and corrective arms of the Stability and Growth Pact. Two regulations (1175/2011 and 1177/2011) and in particular the Budgetary Frameworks Directive are the key pieces of legislation steering the reporting on contingent liabilities. Under the directive, Member States have an obligation to publish details on contingent liabilities. The key sections of the inter-governmental fiscal policy treaty concluded in 2013 were also incorporated into the Finnish legislation by means of the Fiscal Policy Act (869/2012)[8]. The spending limits rule laid out in the Government Programme and the central government spending limits are an essential part of Finland's national fiscal policy framework. The decision on central government spending limits is included in the General Government Fiscal Plan. In addition to the policies laid out in the Government Programme, the Government's fiscal policy is also steered by binding statutory and contractual objectives. The most important of them is the medium-term objective for structural financial position set on the basis of the Fiscal Policy Act.

Central government balance sheet management has been examined on several occasions. In a number of reports commissioned by the Ministry of Finance[9], development of analyses supplementing balance sheet reviews (balance sheet and risk scenarios, stress tests and solvency analyses) have also been examined. Changes in the balance sheet position and the sensitivity of the economic position to such factors as risks arising from guarantee decisions are not currently examined in spending limits reviews. The Parliamentary Audit Committee has on several occasions proposed that the reporting on liabilities should be on a more comprehensive basis.

Changes in the balance sheet position and the sensitivity of the economic position to such factors as the risks arising from guarantee decisions are not examined in spending limit reviews

2.2 Preventive arm in practice: Finland's stability programme

It is stated in Finland's General Government Fiscal Plan that it also contains Finland's Stability Programme and meets the EU's requirement for a national medium-term fiscal plan.

Details of central government liabilities and risks are given in Chapter 4 of the General Government Fiscal Plan. At the end of the chapter it is stated that the 'costs arising from the triggering of central government liabilities may impose a significant burden on the economy. This highlights the importance of careful monitoring and management of central government financial liabilities, particularly in the current volatile external environment condition'. It is also stated that central government liabilities and the risks arising from them are discussed in more detail in the risk report published by the Ministry of Finance. Issues connected with these matters are reviewed in detail in the Chapter 3 of the audit report.

2.3 Corrective arm in practice: Commission's assessment of Finland

On 22 May 2017, the European Commission updated its assessment[10] of the exceeding of the benchmarks laid down in TFEU in Finland. In addition to the debt ratio, the Commission also reviewed what are called relevant factors that may have an impact on the debt level.

In its report, the Commission discusses the value of general government guarantees in relation to GDP in 2016. The conclusion is that the ratio (21.5%) is high compared with other Member States. About one half of all government guarantees were guarantees to companies (excluding housing companies). Guarantees have been provided to a large number of non-financial companies, mostly through the state-owned financing company Finnvera, which promotes exports and business growth. According to the report, the guarantees on housing loans taken out by private households accounted for 28% of the total at the end of 2016. It is stated in the report that both types of guarantees have almost doubled since 2010 and that the rest of the guarantees are connected with the European Financial Stability Facility and student loans. It is mentioned at the end of the report that so far the losses arising from the guarantees have been small.

When assessing the guarantees in its report, the European Commission presents the amounts of the guarantees but does not give any figures describing the losses arising from them. There is no information in the report on how the potential impacts of the guarantees on debt levels have been assessed and the impacts that the guarantees might have on expenditure are not discussed either. It is impossible to draw any conclusions from the report on how government guarantees impact the sustainability of general government finances.

2.4 A new directive: All Member States are now obliged to publish details of significant contingent liabilities

Most of the new requirements are contained in the Council directive on requirements for budgetary frameworks of the Member States[11] (Budgetary Frameworks Directive). Under Article 14(3) of the directive, 'For all sub-sectors of general government, Member States shall publish relevant information on contingent liabilities with potentially large impacts on public budgets, including government guarantees, non-performing loans, and liabilities stemming from the operation of public corporations, including the extent thereof. Member States shall also publish information on the participation of general government in the capital of private and public corporations in respect of economically significant amounts'.

The directive does not lay down any specific elements limiting the growth in contingent liabilities. Publication of the information required under the Budgetary Frameworks Directive in Finland is the responsibility of the Ministry of Finance. Under the directive, Finland must present information that may have an impact on medium-term planning of general government finances. There is no requirement to publish estimates or calculations of how contingent liabilities could impact general government finances. Information that has to be published under the directive is reviewed in more detail in Chapter 3 of the audit report.

3 Is the picture given of the contingent liabilities true and fair?

As a whole, a great deal of information on contingent liabilities is produced because it is provided as administrative reports (final accounts and risk reports) and as statistics or as notes to them. However, the picture given of the sustainability of financial management cannot be considered adequate in all respects.

The magnitude of the risks arising from contingent liabilities remains in many respects unclear as the focus in the reporting is on the amount of the existing liabilities. Some of the information intended for publication is not actively discussed or it is not utilised in the drafting of the Government's annual report or the risk report. The complex structure of some liabilities makes it difficult to interpret the total amounts. Local government liabilities are not reported in an explicit manner.

The risks arising from the liabilities should be described in a more systematic manner, for example by producing overall assessments of risk trends, comprehensive risk scenarios and comprehensive figures of the payments made due to calls of guarantees. This would provide important additional information on the risks arising from the liabilities as a whole.

The situation should be improved by updating the contents of the risk report and by developing the information content of the Government's annual report and the General Government Fiscal Plan, for example by using international models as a basis. This would also ensure that the requirement laid down in the State Budget Decree that the significance of risks must be reviewed in the Government's annual report is met.

3.1 Even though there is a great deal of reporting, the overall picture is characterised by a broad range of different interpretations

A large amount of information is published and there are often differences in the concepts used

As a whole, a great deal of information on contingent liabilities is produced because it is provided as administrative reports (final accounts and risk reports) and as statistics or as notes to them (Table 4).

Getting a comprehensive picture requires combination of information

The risk report, the Government's annual report, final central government accounts, General Government Fiscal Plan and different statistics provide an extensive but partially fragmented picture of the trends in contingent liabilities. A large amount of information is provided but one can only get a comprehensive picture of the situation if one examines figures obtained from a broad range of different sources. Differences in coverage and conceptual differences also mean that the figures presented in different reports are not identical. On a positive note, Statistics Finland, the State Treasury and the Ministry of Finance have taken joint action to consider the differences between the reports and to eliminate differences that are not justified.

The differences between the reports concern such matters as the information publication frequency and the coverage with regard to the events impacting the stock of guarantees (Table 4). The differences are also reflected in the total amount of guarantees reported in the publications.

Table 4: Reports describing guarantee information

	Publication frequency	Total guarantees at the end of 2016, EUR billion	New and expired guarantees	Payments made	Amounts recovered	Itemisation of guarantees
Government's annual report	annual	46.0 (incl. those granted by Finnvera and EFSF)	no	in part	in part	itemisation according to legislative basis and guarantee beneficiary
General Government Fiscal Plan	annual	46.0 (incl. those granted by Finnvera and EFSF)	no	no	no	itemised according to the most important guarantee types
MOF risk report	annual	46.0 (incl. those granted by Finnvera and EFSF)	no	in part	in part	itemisations according to guarantee types and guarantee beneficiary
Statistics compiled by Statistics Finland	on a quarterly basis	45.3 (incl. those provided by Finnvera and EFSF)	yes	yes	yes	aggregated by beneficiary sector
Statistical database of the State Treasury	on a half-yearly basis	46.0 (incl. those provided by Finnvera and EFSF)	no	no	no	broken down according to the most important guarantee types
Eurostat statistics	annual	59.3 (year 2015, incl. those provided by Finnvera and local government)	no	no	no	broken down into standard guarantees and one-off guarantees, itemised by provider sector
IMF/SDDS page	on a quarterly basis	45.3 (incl. those provided by Finnvera and EFSF)	yes	no	no	fully aggregated

There is uncertainty concerning the total amount of guarantees

The guarantee arrangements connected with Finnvera's activities impact the interpretation of the total amounts given in administrative and statistical reports. For example, the relationship between the government guarantees received by Finnvera for its fundraising and the export credits provided by the Finnvera group complicates the interpretation of the figures. It is pointed out in the Ministry of Finance's 2017 risk report that the liabilities connected with export guarantees and the guarantees received by Finnvera for its fundraising are not cumulative in the sense that they could all be fully realised. It is also stated in the report that, to the extent that the debts guaranteed by the state have been used for financing export credits, the state does not have double liability. In practice, this means that the combined total liabilities given in the reports do not as such describe the maximum state exposure to financial losses.

According to the figures submitted by Finland to Eurostat, local government guarantees totalled EUR 22.2 billion at the end of 2015. The risk report of the Ministry of Finance also contains information on guarantees provided by municipalities. However, the relationship between these figures and the information supplied to Eurostat remains unclear. This increases the uncertainty connected with the total amount of general government guarantees and the interpretations of it. Finland has also attached a note to the information sent to Eurostat that because the sources used are not fully comprehensive, the figures describing the total local government guarantees also contain internal general government guarantees.

Statistics Finland published statistical information on government guarantees until February 2017 as separate statistics and after that the figures have been included in the statistics 'General government debt by quarter'.

Based on the source information used in the statistics, Statistics Finland also supplies information to Eurostat as part of the reporting on general government deficits and debts and the reporting required under the Budgetary Frameworks Directive. The guarantee information collected by Statistics Finland is also relayed to the information contents meeting the requirements of the SDDS standard defined and coordinated by the IMF. The State Treasury has also published information of the guarantees it manages in its statistical database and in August 2017, it expanded the data content to cover other government guarantees.

The overall picture of the risk position may remain inadequate

Fragmented reporting and vagueness concerning the information provision responsibilities may lead to an inadequate overall picture of the risk position. The picture of the actual losses relayed to Parliament, other decision-makers and the general public cannot be considered adequate. The reporting on the substantial guarantee loss incurred by Finnvera in 2016 demonstrated the existence of the problem. The reports published on the matter did not give a clear picture of the amount of the actual losses and the payments made. From the perspective of transparent financial management, provision of information on substantial losses and the impacts of the hedging arrangements should be comprehensive and the information provision responsibilities clearly defined.

3.2 Contingent liabilities are now more extensively reported

The liabilities are now discussed more extensively in the Government's annual report and the work to centralise the information base has started

Under section 18 of the State Budget Act (423/1988), the descriptions of central government finances, central government financial management and operational performance included in the Government's annual report must provide true and fair information on such issues as the central government's financial position. Information on government guarantees is part of information on central government's financial position. Under the amendments to the State Budget Decree that entered into force in 2016, the Government's annual report must contain a 'review of the state of general government and central government finances and an assessment of the most important economic risks arising from central government activities and their significance'. The wording of the State Budget Decree leaves a great deal of room for interpretation concerning the extent of the presentation of the risks.

The State Budget Decree leaves room for interpretation concerning the presentation of risks

The section of the Government's annual report describing central government finances and the note 12 to the final central government accounts appended to the report contain information on trends in contingent liabilities (government guarantees, pledges and other commitments). In the annual reports on 2012[12] and 2013[13], government guarantees were only cursorily described.

The 2014 annual report[14] contained a concise description of the risk realisation mechanisms. The guarantees granted by Finnvera were also included in note 12 to the final accounts. In the year after that[15], the scale of the liabilities was described more extensively, on the basis of international comparison data. In the 2016 report[16], guarantees are reviewed more extensively. The report presents EU-level comparison data on trends in total liability portfolios over the three preceding years, Finnvera's risk structure is discussed in more detail and details of guarantee fees and compensations for losses are also given.

A substantial proportion of the guarantees provided by off-budget units is managed by the State Treasury. In May 2016, the State Treasury issued a regulation[17] under which data on guarantees not managed by it must be supplied to the State Treasury on a quarterly basis. In the State Treasury, the information is collected into KoTa (interest subsidy and government guarantee management system). The data also includes the guarantees granted by Finnvera. The concentration of the information can be considered a positive development as it provides the Government's annual report with a more unified information base.

Concentrating the information collection process helps to unify the information base

The data content meeting the requirements laid down in the State Treasury's regulation corresponds to the information requirement laid down in note 12 to the final central government accounts, which in turn is defined in the State Budget Decree. This means that such matters as the details of guarantee payments made are not covered by the information collection requirement. Because of the significance of such elements as payments made, and to ensure up-to-date and comprehensive information, it should be examined whether the KoTa data content and the information provided under the State Treasury regulation should be expanded.

Guarantee compensations paid are outside the scope of the information collection requirement

Starting the publication of regular risk reports was a significant step forward

In 2015, a Ministry of Finance working group presented its report[18] on the development of the reporting and management of central government financial risks. The report discusses such contingent liabilities as the guarantees granted by Finnvera, those provided as part of on-budget entities and extra-budget funds, central government contractual liabilities, capital liabilities associated with international financial institutions, liabilities connected with the management of the euro crisis, liabilities connected with state-owned companies and liabilities in the banking sector.

The risk report has been published annually. The description of the contingent liabilities contained in the report has become more comprehensive each year. There has been progress in the section describing the activities of Finnvera and the description of the government guarantee received by the Bank of Finland for IMF funding is also more comprehensive than in the past. Likewise, the liabilities connected with the management of the euro crisis are now also more extensively reviewed. The estimation of scale of risk realisation is given in euros and uncertainty in the estimates is also pointed out.

The General Government Fiscal Plan describes trends in government guarantees and capital liabilities

The risk report is published separately from the General Government Fiscal Plan and the Government's annual report. General government liabilities and risks have been only briefly described in the General Government Fiscal Plan each year[19]. The description contains a table presenting the amounts of the most important liability items of the government, such as guarantees and capital liabilities, and a brief explanation of them. In addition, the amount of

The risk report is published separately from the Government's annual report and the General Government Fiscal Plan guarantees in Finland is also compared with the situation elsewhere in the EU. There is little information on the magnitude or significance of the risks and the risk realisation mechanisms are only described at very general level.

The General Government Fiscal Plan has also served as Finland's stability programme. The preparation of the stability programme is guided by a code of conduct[20] under which the total amount of the general government guarantees should be given in the document. However, the reporting in the General Government Fiscal Plan only covers central government, which differs from what is set out in the code of conduct.

3.3 The reporting at national level has not been developed in accordance to the requirements laid down in the Budgetary Frameworks Directive

Under the Budgetary Frameworks Directive, particular consideration should be given to contingent liabilities

Under the Budgetary Frameworks Directive, for all sub-sectors of general government, Member States must publish relevant information on significant contingent liabilities, including government guarantees, non-performing loans, and liabilities stemming from the operation of public corporations. Member States must also publish details of their ownership in public corporations.

Eurostat, the statistical office of the European Union, publishes statistics[21] on contingent liabilities in all Member States. In Eurostat publications[22], contingent liabilities are divided into guarantees, off-balance sheet public-private partnerships (PPPs), and liabilities of government-controlled entities classified outside general government (public corporations). The information published by Eurostat also includes the details of non-performing loans. In terms of their economic importance, general government debt, guarantees and the debts of public corporations constitute a substantial sum in relation to GDP (Figure 2).

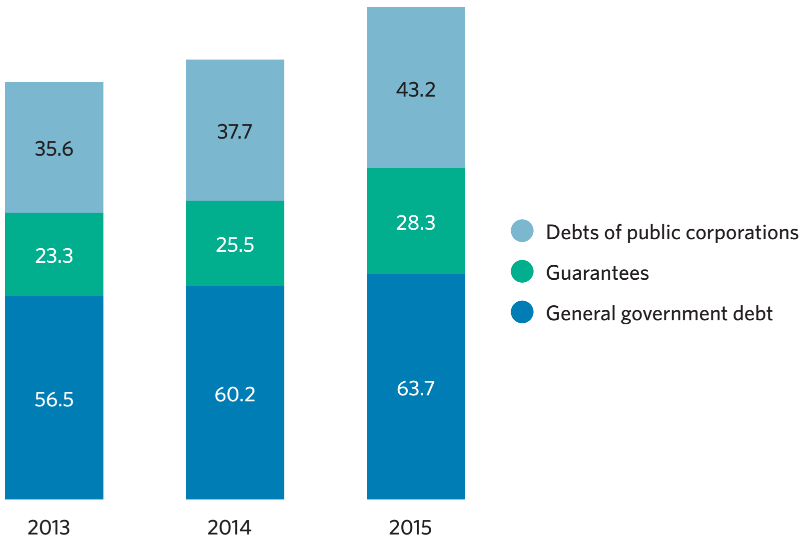

Figure 2: General government debt, guarantees and debts of public corporations in relation to GDP (%) in Finland between 2013 and 2015. The items should not be added up as they contain overlaps. For example, the government-guaranteed debts of public corporations are shown under guarantees and in the debts of public corporations. In this case, the risk can only be realised once and for this reason, adding the figures together would produce an excessive estimate of the liabilities.

Information on all areas of contingent liabilities is not actively disseminated in Finland

The European Commission stated in 2015[23] that not all Member States had used the information based on the Budgetary Frameworks Directive to enhance the transparency of general government finances as they had only met the minimum requirement for the publication of information at national level. The information content meeting the requirements laid down in the Budgetary Frameworks Directive is difficult to find as a separate report in Finland and it is not actively promoted. In Finland, transparency has been primarily enhanced by means of risk reports, Government's annual reports and the final central government accounts and not with the reporting based on the directive. For this reason, the publication of the information in accordance with the requirements of the Budgetary Frameworks Directive should be assessed in relation to changes in other reporting.

The risk report published by the Ministry of Finance is the main document containing information parallel to the content specified in the Budgetary Frameworks Directive. The risk report is more up to date and detailed source of information on guarantees. Moreover, EU-level comparisons published by Eurostat have also been used in the risk report and the Government's annual report. Debts of public corporations are an essential part of the information published under the Budgetary Frameworks Directive. This information is not included in the risk reports or the Government's annual reports.

Information on the debts of public corporations is collected but it is not used in the reporting

International comparisons are useful but the information is not always fully comparable

In its 2017 risk report, the Ministry of Finance highlights the difficulty in comparing the nominal values of guarantees between countries, which is partially the result of differences between national reporting practices.

International comparability of the information on contingent liabilities is also hampered by the fact that, in addition to explicit guarantees, many countries also use different types of permanent and general guarantee arrangements that are incorporated into the legislation, that apply to the liabilities of entire companies and that are not shown in guarantee statistics. Other reporting and methodological solutions also have an impact on the scope of the guarantee statistics and there is no certainty of uniform practices across countries.

It is unclear whether different countries present guarantee information in a uniform manner

The differences arising from reporting practices and other national arrangements may be substantial. For example, in comparisons between countries, straightforward interpretations of rankings should be avoided and when annual changes are reported, the underlying components of changes need to be carefully analysed.

3.4 Reporting on contingent liabilities should be improved

There should be a more comprehensive picture of the sustainability of central government finances

Current reporting does not give an adequate picture of the sustainability of the financial management. This is because the potential future expenditure impacts of the current liabilities are not comprehensively described. For this reason, the contents of the reporting should be improved, for example in accordance with the best international practices. The existing risk reporting has helped to provide a more comprehensive picture of the contingent liabilities and it serves as a good basis for the further development of the reporting on this topic. In the future, different reports should be developed as a whole. Extensive presentation of overlapping information in different reports should be avoided. This means that the significance and information content of each report should be more clearly defined. Especially in the development of the content of risk reporting, consideration should be given to the relationship between the risk report and the Government's annual report, which must be submitted to Parliament by law. In this work, the focus should also be on the development of the information describing financial risks and their significance, as required under section 68 of the State Budget Decree. There should be a stronger focus in the risk report on the analysis of risks and the reporting itself should be more concise and analytical. The length of the report could be shortened by leaving out information that is included in the Government's annual report in identical form.

Description of local government liabilities complements the information on the general government risk position

The report should provide a clearer picture of the overall general government risk position. A description of the amount and types of the local government guarantees should be included in the General Government Fiscal Plan. Moreover, details of the guarantees should also be presented in different reports in a uniform manner or any conceptual differences should be explained.

Development trends can be outlined by applying international models

There is substantial international variation in the reporting on contingent liabilities. Development trends can be found in international reporting standards and guidelines, as well as in the practices adopted by other countries. The Fiscal Transparency Manual[24] of the International Monetary Fund (IMF) identifies the following areas in the reporting on guarantees:

- description of the type, purpose and intended beneficiaries of the guarantee, and its expected duration
- gross exposure of central government and, if possible, an estimate of the costs arising from the guarantee payments
- payments made, amounts srecovered, stock of receivables, cancelled receivables
- fees charged for the guarantees or other revenue.

IMF: Finland does not provide regular information on the likelihood of losses

Similarly, in advanced-level reporting on guarantees meeting the recommendations set out in the IMF Fiscal Transparency Code[25], the likelihood of the triggering of guarantees is given at least on an annual basis. In its Fiscal Transparency Evaluation on Finland in 2015[26], IMF drew attention to the fact that Finland does not regularly publish information on the likelihood of losses.

Risk analyses of government guarantees and lending have been published in Sweden on an annual basis since 2012[27]. The report is prepared by the government debt office in cooperation with the units providing and managing guarantees and loans. The reporting is based on the Swedish budget act under which the government must report to Parliament on such issues as the risks and expected losses arising from guarantees and lending.

The report covers the most important types of liabilities together, with the exception of deposit guarantees, which are reviewed separately. Concentration of the liabilities is described geographically and on a sectoral basis. The most important risk concentrations are also listed (without mentioning the beneficiary companies). The risks arising from the liabilities are illustrated with scenarios, which describe the potential losses associated with the guarantee and loan portfolios, both at expected and unexpected levels.

The information content also provides an overall picture of the past losses, revenue from recoveries and guarantee fees, as well as the net cash flow arising from the combined effect of the three. The risks associated with the deposit guarantee system are extensively described. The report also contains a great deal of descriptive information about the risks associated with the liabilities and the likelihood of them being realised.

As a whole, the Swedish reporting practice provides a more open and clearer picture of the risks associated with contingent liabilities than the reporting practice used in Finland. The report gives a clear picture of the risks arising from large losses within a timespan of a few years and the parties using the information are provided with an easy-to-understand assessment of the magnitude of the risks and changes in it on a year-on-year basis. The risk of substantial losses is comprehensively analysed in the technical part of the report using a broad range of different methods. The calculation methods and background assumptions used are described in a transparent manner in the appendix to the report.

The Swedish reporting practice gives a clear picture of the magnitude of the risks and the risk trends

More information should be provided on the liabilities of public corporations, realised guarantee losses and changes in the guarantee portfolio

In the current situation, statistical information and administrative reports complement each other. Statistics contain essential information that is absent from administrative reports but on the other hand, the data protection requirements applying to statistics prevent a more detailed analysis of development trends.Inevitably, this makes it more difficult to form an overall picture of the trends in contingent liabilities and the reasons behind the trends.

Essential information on guarantees is missing from administrative reports

For this reason, the information content of the risk report and (as applicable) of the Government's annual report should also cover new and expired guarantees, payments made (on a cash basis), revenue received from recoveries and guarantee fees collected. The details of new and expired guarantees would help to provide a more comprehensive picture of the changes taking place in the guarantee portfolio. At the same time, comprehensive details of the payments made would ensure that up-to-date information on realised risks and, consequently, the total risks associated with the liabilities, is available.

In the current reporting, the risks associated with public corporations are only cursorily discussed. The reporting should be extended by providing an analysis of the future risks associated with public corporations. In the first stage, the contents could be developed to this direction by including in the reports the existing information on the debts of public corporations. It would be important that the information collected under the Budgetary Frameworks Directive would be used in full.

The risks associated with public corporations are only cursorily discussed

All aspects of the euro liabilities should be described

The description of the management of the euro crisis in the risk report provides useful information on the liabilities associated with the crisis, and the management of the risks arising from them. The size of the risks is also assessed. In 2012, the National Audit Office expressed the view[28] that a situation where the indirect liabilities transferred to Finland through the European Central Bank are not presented by any party together with Finnish government direct liabilities makes it difficult to produce an overview of Finland's total liabilities and risks.

In the compilation of euro liabilities regularly published by the Ministry of Finance[29] it is stated that the Bank of Finland reports on its risks and liabilities independently. The fragmented nature of the reporting still provides an obstacle to forming an overall picture and the need for an overall review still exists. The operations of the Bank of Finland as part of the euro system also have conditional impacts on central government finances. The risk report and the Government's annual report should describe the Bank of Finland's liabilities connected with the euro crisis, the amount of the liabilities and the manner in which they can have an impact on central government revenue and expenditure.

The contents of the reporting should be developed by introducing clear scenarios

Even though the risk report contains concrete examples of the risks connected with Finnvera and gives a particularly clear picture of Finnvera's concentration risk, the risk report and particularly the Government's annual report only provide a superficial and fragmented analysis of the risks arising from the liabilities. The reports do not contain comprehensive scenarios of what would happen if the risks are realised and the picture of the risk trends remains fragmented. For this reason, it is not entirely clear whether the current information content of the Government's annual report meets the reporting requirement concerning the significance of risks as laid down in the State Budget Decree.

In the audit office's view, the risk content of the contingent liabilities could be described more extensively and in a more systematic manner. Both the examination of the risks as a whole and the review of specific sectors could be improved. Using Sweden as a model, there should be overall assessments of the risk trends and comprehensive risk scenarios for analysing expected and unexpected developments connected with compatible liability categories. This would help to provide a more concrete picture of the potential losses, which in turn would make the parties involved more aware of the risks arising from the liabilities.

The risk content of the liabilities could be described more systematically

4 Is there any assessment of the risks that central government might incur as a result of the contingent liabilities?

From the perspective of the sustainability of central government finances, information on the risks arising from contingent liabilities and the risk trends should be produced in the annual reports and when the liabilities are accepted. Already in 2011, the working group assessing central government balance sheet management pointed out that central government risks are rarely assessed at group level. Furthermore, no group-level limits or other risk limits have been set. In central government, the management of risks arising from contingent liabilities and the related decision-making have been decentralised to individual units. The risk assessment procedure has not been harmonised, which means that each body can determine the contents of the risk assessment itself.

The audit covered Finnvera and the National Housing Fund because these two bodies have the largest liability portfolios. The granting authorisations of Finnvera are on a statutory basis, while the National Housing Fund's granting authorisations are laid out in the state budget. The two bodies apply different decision-making and preparatory practices and they also assess the risks involved in different ways. There are no obligatory information content requirements for risk assessments, which means that the contents of the assessments vary and the information that they produce about risks is inadequate.

Finnvera reports on its risk position to the Ministry of Economic Affairs and Employment on a quarterly basis as separate reports in connection with the ownership control reports. The Ministry of Economic Affairs and Employment has not made any decisions concerning the content requirements for the risk reports. The financial supervision of Finnvera has not been at the level required by law. The Internal Audit Unit of the Ministry of Economic Affairs and Employment (which is responsible for the external financial supervision of Finnvera) does not have in place an up-to-date plan concerning the contents of the supervision activities. Only limited resources have been allocated to the supervision. In January 2018, the Ministry of Economic Affairs and Employment decided on the regulations issued by the Financial Supervisory Authority that the ministry will apply to its financial supervision of Finnvera Plc.

The state owner has not set any clear limits to the risks that Finnvera may take. The owner has only set a limit to the amount of commitments and given Finnvera a long-term self-sustainability target. Finnvera has set risk limits to its own operations and these are set out in the board-approved documents concerning the company's credit and guarantee policy and its risk appetite. However, they do not actually limit risk taking because they can be exceeded by a board decision.

In its continuous risk reporting, the National Housing Fund focuses on the risks arising from the Arava loans. It has not paid equal attention to the growing portfolio of guarantee and subsidised loans.

4.1 The risks arising from contingent liabilities are not assessed at central government level

There is no overall assessment of the potential impacts of the risks on central government finances

In 2011, the working group assessing central government balance sheet management[30], pointed out that the sustainability of central government finances is largely examined on the basis of the budget deficit and gross debt. These indicators are considered as critical from the perspective of the long-term sustainability of central government financial position. No systematic framework for examining solvency at group level exists, however. The financial position of the State of Finland is sensitive to a broad range of different risks, including those concerning guarantee and credit decisions. It is stated in the report that no risk appetite has been defined for central government at group level and the risk-taking level of the group is not steered in a systematic manner. Moreover, the potential impact of the risks on central government solvency and debt servicing capacity is not systematically assessed at overall level. However, it is concluded that in separate units or for specific balance sheet items, risk appetite and the risk-taking level are steered more systematically. The debt servicing taking place as part of the on-budget activities is given as an example.

No consideration is given to contingent liabilities in the current debt-servicing strategy of the State of Finland. The regulation of the Ministry of Finance only applies to on-budget debt and its servicing. On 12 May 2017, the Ministry of Finance appointed a working group[31] tasked with assessing the management of liquidity risks in a situation characterised by a rapid growth in indirect government liabilities.

State-owned companies do not have any separate risk management guidelines

The Parliamentary Audit Committee has also drawn attention to the fact that state-owned companies have not been provided with separate risk-management guidelines. The Government resolution on state ownership policy sets out the general principles on the ownership policy and ownership steering but it does not contain any specific guidelines on state-owned companies' risk management. The Parliamentary Audit Committee stated that state-owned companies should have proper risk-management arrangements and called for the Government to issue guidelines on the matter. [32]

A proposal for a reporting and decision-making framework for off-balance sheet government liabilities is under consideration

A status report on off-balance sheet government liabilities was prepared on 13 February 2017 for the Government's strategy session. It was agreed in the session that based on the principles laid out in the report, a proposal for a reporting and decision-making framework concerning off-balance sheet government liabilities will be prepared. The purpose of the framework is to support the Government and the Cabinet Committee on Economic Policy in their decision-making. According to the Ministry of Finance, the key areas in the decision-making framework include the following: decision-making process for new liabilities and changes in existing liabilities (careful preliminary assessment), assessment criteria (burden of justification and proof would lie on the party proposing additional liabilities) and the identification and assessment of risks and reporting on them.

4.2 There are no minimum information requirements concerning the assessment of the risks arising from the guarantee authorisations

The guarantees and interest equalisation loans granted by the specialised financing company Finnvera are used to support exports and SMEs. By law, the State of Finland has ultimate liability for these commitments. The granting of the commitments is steered with the granting authorisations laid down in the law.

The assessment of the economic impacts on general government finances and the methods and information sources available are discussed in detail in the guidelines for assessing the impacts of legislative proposals supplementing the instructions for drafting Government proposals. The instructions list a number of ways to assess costs and risks. However, no decision has been taken on the minimum information requirements for the decision-making process and there is no legislation on the matter either.

Minimum information requirements should be defined so that the risks arising from guarantee authorisations could be assessed in a more comprehensive manner

According to the audit, economic impact assessments of the authorisation decisions vary in content and it is impossible to produce an overview of the risk scenario or foreseeable costs. Compared with the information contained in the guidelines for assessing the impacts of legislative proposals, the assessments of the impacts of the increases in Finnvera's authorisations contained in the Government proposals to Parliament can be considered rather meagre, especially with regard to quantitative estimates (Table 5). The small number of quantitative estimates makes it more difficult to produce an overview of the costs and risks arising from the proposals and to assess them in a proper manner. The quantitative assessment of the risks can be difficult in many cases. However, to make the risk assessments more uniform and comprehensive, the Government should perhaps use the methods set out in the guidelines for assessing the impacts of legislative proposals concerning the manner in which issues are presented and create a more structured and comprehensive way of presenting the economic impacts in Government proposals to Parliament.

Table 5: Examples of presenting economic impacts[33] and Government proposals 2014-2016

Guidelines	HE 243/2016	HE 144/2015	HE 58/2014
Have alternative measures been proposed?	Current level of authorisations as an option, no quantitative assessments of its impacts have been produced. No other options.	Current level of authorisations as an option, no quantitative assessments of its impacts have been produced. No other options.	Current level of authorisations as an option, no quantitative assessments of its impacts have been produced. No other options.
Itemisation of preparations for financing	Summary of funds	Summary of funds	Summary of funds
Review of impacts during different time periods	No quantitative assessments exist.	No quantitative assessments exist.	No quantitative assessments exist.
Cost-to-benefit analysis	No quantitative comparisons exist.	No quantitative comparisons exist.	No quantitative comparisons exist.
Assessment of risk significance and distribution	Quantitative assessment of the credit risk using the VaR figure, no assessments of interest rate risk	Quantitative assessment of the credit risk using the VaR figure, no assessments of interest rate risk	No quantitative assessments
Have the underlying assumptions for the assessments and the assessment methods been presented?	Only partially	Only partially	No
Magnitude and probable variation	Has not been presented	Has not been presented	Has not been presented
Sufficient statistical information base	Information base has not been reported.	Information base has not been reported.	Information base has not been reported.
Average figures and extreme cases	No	No	No
Outside expertise has been used	Assessments supplied by Finnvera	Assessments supplied by Finnvera	Assessments supplied by Finnvera

The buffers built to safeguard financing are appropriately itemised in the Government proposals for increases in Finnvera's guarantee authorisations. The adequacy of the buffers is assessed by comparing them with the VaR figure calculated on the basis of the probability distribution. The VaR figure gives the loss that will not be exceeded during the following year, given a specific level of probability. The conclusion is that the buffers exceed the risk figure, which means that they are covered.

Magnitude of the interest rate risks is not assessed

Focus in the quantitative assessment of risks is on the credit risk. The magnitude of the interest rate risk is not assessed on a quantitative basis even though the potential costs arising from interest rate risks are considered substantial in the proposals for higher authorisations. In other words, the assessment fails to give any consideration to a major risk type. The Ministry of Economic Affairs and Employment is of the view, however, that it is sufficient that the sensitivity analysis of interest rate changes is presented to the Cabinet Finance Committee when large export credits are discussed.

It is assumed in the Government proposals that the credit risks taken on the basis of the authorisations do not have any cost impacts. Details of Finnvera's past guarantee schemes and the fact that no appropriations have been allocated are used as a basis for the assumptions. However, on the basis of these facts, it is impossible to make any conclusions of future costs. Long-term cost trends have not been estimated either.

The estimate is that the credit risks taken do not generate any costs

No alternatives to the legislative proposal have been presented and no impact assessments have been used to justify the solutions. Not increasing the authorisations has been the only alternative mentioned by the Government. However, the quantitative impacts of this option have not been estimated in the proposal either. It is not possible to reach any conclusions of the average impacts or the probable range of the impacts on the basis of the VaR figures. The reliability of the estimates is also weakened by the fact that the assumptions, methods and information base behind them are only briefly discussed in the Government proposals. The risk is only assessed on the basis of a single scenario, which means that the impacts of changed assumptions cannot be observed.

International assessment of export financing urged Finnvera to reduce risk concentrations

In the rationale to the Government proposal for increase in Finnvera's authorisations (58/2014), it was stated that an assessment of the functioning and effectiveness of the government guarantees and government-supported export financing system should be produced by the end of 2016. The Parliamentary Commerce Committee also wanted to be informed of the assessment made. In the Government proposal 144/2015, the assessment was expanded to cover the risks associated with the export financing system.

The international assessment group started its work in November 2016. The assessment report[34] was published on 1 February 2017. The impact assessment was on a fairly weak basis as it relied on the analysis of previous studies and no new analysis was carried out. No new analyses had been requested in the invitation to tender. Only a small number of effectiveness-related recommendations were given in the assessment. It was stated in the report that growing liabilities and the concentrations arising from them constitute a substantial threat.

In an international assessment, Finnvera was urged to reduce concentrations

The risks resulting from export activities were also reviewed in the report. The conclusion was that the market and financing risks faced by Finnvera are in small scale and that the risk management arrangements are on an excellent basis. The evaluators noted the large credit risk concentrations. The report contained the consultants' own assessment of Finnvera's total risk in a situation where the authorisations are fully used and a calculation of the costs arising from the optionality included in subsidised loans. With regard to risk management, it was recommended in the report that Finnvera should have fewer concentrations, change its capital requirement model and take into account the costs resulting from the interest rate risk.

4.3 The risks and costs arising from contingent liabilities are not fully shown in the state budget.

The content of the risk assessments of the subsidised and guarantee loan authorisations are not defined in detail

The matters approved and decided in connection with the consideration of the state budget are laid down in section 7 of the Act on the National Housing Fund (1144/1989). Separate requirements for risk assessments are not included in them. According to ARA, the perspective of risk assessment is considered in the Government-approved plan for using subsidised and guarantee credits and the performance management of ARA by the Ministry of the Environment even though a risk assessment is not required for justifications for granting guarantee and subsidised loans when they are given under the state budget. The risk perspective is considered to be an important aspect in practical operations and few of the guarantee risks assumed by the government have been realised.

The costs arising from the use of Finnvera's guarantee authorisations are not fully considered in the state budget

The costs arising from the use of the guarantee authorisations granted to Finnvera under the law are not fully taken into account in the state budget. The compensations for guarantee losses paid to Finnvera each year by the government and the deficit compensations paid to Finnish Export Credit are shown in the state budget. However, only small variable appropriations have been allocated for any other costs arising from the guarantees of Finnvera's commitments in the longer term (such as the guarantee compensations payable by the state in its capacity as the ultimate guarantor). This appropriation can be used if the assets of Finnvera's export credit guarantee and special guarantee fund and the off-budget State Guarantee Fund are insufficient to cover the losses.

It is stated in the budget proposals that the large risk concentrations held by the State Guarantee Fund increase the need to maintain the fund's liquid assets at a level where liquidity is in accordance with the higher risk position. The budget proposals do not contain more detailed information on the higher risk position, total cash reserves in relation to the higher risk position or the cash reserves required for managing the risk. In other words, the total costs resulting from the risk taken by the government are not even shown in the state budget as a pre-realisation estimate.

The total costs resulting from the risk taken by the government are not even shown in the state budget as a pre-realisation estimate

Not presenting the total costs in the state budget may provide an incentive to use guarantees instead of the on-budget expenditure items. In the long run, this may lead to an economically unfavourable solution and make the use of the funds less transparent.

Leaving the total costs outside the state budget may serve as an incentive to use guarantees

Following the financial crisis, a temporary solution in which Finnvera started providing exporters with direct credits was introduced. This arrangement was mainly based on fundraising by the government in which the government provided Finnvera with the funds that the company needed for its lending. The temporary solution was made permanent in 2012 and

Finnvera was made responsible for raising the funds for its export credits. Raising funds for Finnvera's credit-based export financing is founded on government guarantees that Finnvera has received free of charge. For the purposes of national accounts, Finnvera is not part of general government as it is included in the financial sector. The export credit financing received by Finnvera is therefore not considered central government debt even though Finnvera relies on directly enforceable government guarantees in its fund-raising. The Parliamentary Commerce Committee[35] has drawn attention to the fact that as export credits have been made a Finnvera responsibility, the government liabilities arising from them are no longer directly shown in the state budget.

The purpose of international recommendations is to ensure that expected costs can be considered so that contingent liabilities can be processed in a neutral manner

Considering guarantees in a neutral manner as part of the state budget process would ensure that circumventing economic policy restrictions is not the only reason to use guarantees. To promote neutrality, it is proposed in an OECD discussion paper[36] that the following elements should be incorporated into the guarantee practice:

- A fee based on the costs that the government is expected to incur is charged for the guarantees. The fee should include a risk margin, which the beneficiary of the guarantee would have to pay to a private guarantor.
- If the guarantee is to be provided at a price lower than the market price, the difference between the market price and the lower price should be funded through appropriations approved by decision-makers.

The main benefit of the scheme would be that the state aid included in the guarantee would be visible as a cost when the guarantee is provided. If the expected guarantee costs are incurred by the state, appropriations are required and the aid element will be visible. If the guarantee fee is collected from the beneficiary, there is no aid element and no appropriations are required. Guarantees will become neutral as policy instruments in relation to other instruments as loans and grants. Neutrality will eliminate the incentive to favour guarantees.

4.4 Risk assessment and risk reporting practices vary between agencies

The Ministry of Economic Affairs and Employment has not specified the contents of Finnvera's ownership control and risk reports

In 2005, government responsibility for Finnvera was changed from indirect responsibility to direct and absolute responsibility[37]. The working group considering the matter[38] concluded that with changes in the government responsibility (from indirect to direct responsibility), the ownership and business policy control exercised by the government over Finnvera and the reporting on Finnvera Plc should be developed and made more comprehensive so that government risk management could be made more effective. According to the working group, reporting on special risk taking should also be expanded so that the assessment of special risk taking would be discussed at the Cabinet Committee on Economic Policy each year as part of the overall assessment of Finnvera Plc's risks. Government supervision of Finnvera and the reporting on Finnvera Plc's operations are not covered in the Government proposal for the legislative amendment (HE 177/2005), and no definitions for them are given in the document.

Finnvera reports on its risk position to the Ministry of Economic Affairs and Employment on a quarterly basis as separate reports in connection with ownership control reporting

Finnvera's ownership steering and control were two separate functions in the ministry in the early years of the 2000s. It could not be determined in the audit whether there was a separate agreement at the time under which Finnvera would report on these matters to the owner. According to the Ministry of Economic Affairs and Employment, it does not have any separate contract documents setting out the contents of the ownership control and risks reports. It is stated in the report submitted by the ministry that Finnvera reports on its risk position to the Ministry of Economic Affairs and Employment on a quarterly basis as separate reports in connection with the ownership control reports. The contents of the reports are discussed on a regular basis and they are agreed on in a steering group. At the same time, the reports are also developed and supplemented as necessary.

The Ministry of Economic Affairs and Employment provides Finnvera with business policy and ownership policy objectives. The purpose of the ownership control reports is to verify that the objectives set out by the owner are achieved. There are three business policy objectives impacting the trends in guarantee amounts and risks. In two of the objectives, the emphasis is on the safeguarding of the functioning and competitiveness of the export financing system; in one of them, Finnvera is encouraged to make use of the option of special risk taking. The third objective is connected with the use of EU financing.

Finnvera has also been provided with ownership policy objectives, which regulate the self-sustainability and efficiency of its operations and the solvency of the company. Under the self-sustainability target set for Finnvera, the company's operating revenue should cover its expenditure over a time period that is longer than a business cycle. In SME funding, this period is 10 years and in export financing 20 years. Under the efficiency target, productivity should grow by an average of four per cent each year. With regard to solvency, the target for the period 2016–2019 is that in domestic operations, the Tier 2 solvency ratio would be between 10 and 20 per cent, as calculated using a Basel III-based standard method. However, unlike in the past, the solvency target does not apply to all Finnvera operations. The target for the year 2013 was that the solvency ratio of the Finnvera group should be within the above range.

Government assumed direct and absolute responsibility for Finnvera Plc in 2005

In 2005, government responsibility for Finnvera was changed from indirect responsibility to direct and absolute responsibility[39]. This helped to ensure that the liability portfolio covering the export guarantees and special guarantees provided by Finnvera Plc would still be recognised as zero-risk weighted in the solvency calculations of credit institutions after the introduction of Basel II regulation. The national banking supervisor may grant the country's official export guarantee agency a state-specific risk weight if the government liability for the export guarantee agency's commitments meets the requirements laid down in Basel II regulation concerning the directness, explicitness, irreversibility and absoluteness of the liability. Without the change the requirements would not necessarily have been met and the loans guaranteed by Finnvera could no longer have been classified as zero-risk loans. It would have been impossible to receive funding for export projects on favourable terms made possible by the zero-risk weighting. It was also assumed that Finnvera might no longer have been able to provide SMEs with funding on favourable terms.

National arrangements are key to the regulation of specialised financing companies and control of financing risks

The CRD IV package of the EU comprises the Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR). The purpose of these two pieces of legislation has been to improve the banks' risk-bearing capacity by strengthening their solvency and liquidity position and risk management. The Capital Requirements Regulation contains provisions on the calculation of minimum prudential requirements, large exposures and public disclosure requirements. The single supervisory mechanism was put into effect in November 2014. Under the mechanism, the supervision of banks is the responsibility of national supervisory authorities (in Finland, the Financial Supervisory Authority) and the European Central Bank.

The bodies to which the Capital Requirements Directive is not applied are listed in Article 2 of the directive. Finnvera Plc and the Finnish Fund for Industrial Cooperation Ltd are the Finnish bodies included in the list. The Contact Committee of the Supreme Audit Institutions of the European Union noted in its 2015 opinion that the financial institutions referred to in Article 2(5) of the Capital Requirements Directive remain outside the control of the European Central Bank and the competence of the national supervisory authorities.[40]

The Ministry of Economic Affairs and Employment has decided to start using applicable regulations issued by Financial Supervisory Authority in the supervision of Finnvera

The legislation on credit institutions was applied to Finnvera's predecessor Kera Oyj, which was supervised by the Financial Inspection Authority like all other Finnish credit institutions. The Act on Credit Institutions has not been applied to Finnvera after its establishment and the Ministry of Economic Affairs and Employment was made responsible for its supervision. The supervision of Finnvera is the responsibility of the ministry's internal audit unit. Under the Act on Finnvera, applicable principles observed by the Financial Supervisory Authority in the supervision of credit institutions must be considered in the supervision of the company. In the past, the Ministry of Economic Affairs and Employment did not have any specific ownership control principles, making it difficult to plan and implement the control. In January 2018, the Ministry of Economic Affairs and Employment decided on the regulations issued by the Financial Supervisory Authority that it will apply to the financial supervision of Finnvera Plc. The decision will provide a better basis for improvements in the planning and implementation of the supervision.

There have been no plans on the content of financial supervision

According to the audit findings, the Internal Audit Unit of the Ministry of Economic Affairs and Employment (which is responsible for the external financial supervision of Finnvera) has not had any up-to-date plans concerning the contents of its continuous supervision activities or the manner in which the audits are targeted. In practice, the supervision has been limited to reviewing the reports submitted by Finnvera, to meetings and a small number of audits focusing on specific issues, which may have been ordered from external bodies.

The Internal Audit Unit of the Ministry of Economic Affairs and Employment has not had any up-to-date plans concerning the contents of its continuous supervision activities or the manner in which the audits are targeted.

According to the audit findings, the Internal Audit Unit of the Ministry of Economic Affairs and Employment has not continuously supervised the assessment of Finnvera's risks and capital, which are an essential part of financial supervision. These sectors have, however, been covered in individual audits. In banking supervision, the Financial Supervisory Authority produces annual assessments of such issues as the risks faced by banks and the capital required to cover these risks and compares these assessments with those produced by the banks themselves. The Financial Supervisory Authority also carries out stress tests on banks, which show whether banks have enough capital to withstand unexpected shocks. Such elements are absent from Finnvera's external financial supervision.

The Internal Audit Unit of the Ministry of Economic Affairs and Employment has only commissioned one external assessment of Finnvera's credit risk model as part of its external financial supervision. The assessment discusses the manner in which Finnvera provides its customers with credit ratings and it does not cover other parts of the credit risk model. The Financial Supervisory Authority requires that the model is validated by the banks. It also compares the assessments produced with the model to its own assessments and those prepared by other banks. Updating the financial supervision of Finnvera in accordance with statutory requirements was already recommended in NAOF's audit report 1/2015 on export financing.

In order to improve the situation, the Ministry of Economic Affairs and Employment has ordered from an auditor company a solvency assessment framework applicable to Finnvera and a corresponding assessment of the company's current solvency position.

Finnvera's risk taking is limited by maximum authorisations and self-sustainability target

As the owner of the company, state has placed two limits to risk taking by Finnvera: The authorisations laid down in special legislation on Finnvera place upper limits to the liabilities that the company can assume. Self-sustainability targets have also been set for Finnvera's operations. The upper limit does not take into account risk differences between projects with equal nominal values. Moreover, the authorisations have been raised whenever this has been considered necessary.

The upper limit to the authorisations does not take into account fluctuations in risks

The self-sustainability targets have been defined as time periods during which the company must at least achieve a zero result. For example, the export activities must generate a zero result during a period of 20 years. Risks are seldom realised but if they do, the cost arising from them may be substantial. For example, between 1983 and 1996, export guarantee activities posted losses of more than EUR 800 million after having generated profits for twenty years (Figure 3). Such fluctuations in export guarantee risks make it difficult to measure the achievement of the self-sustainability target.

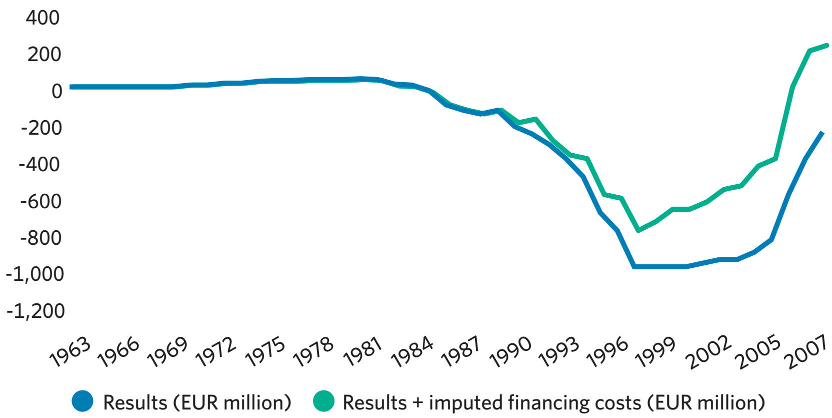

Figure 3: Cumulative results of the export guarantee activities 1963–2007[41]

Finnvera's board has set risk limits but it may also deviate from them

Finnvera has set risk limits to its own operations and these are laid out in the board-approved credit and guarantee policy and the company's risk appetite document. The document outlining the company's credit and guarantee policy set the limits on the basis on which Finnvera provides guarantees and loans. However, the company's board may deviate from the credit and guarantee policy.

Finnvera also takes measures to hedge against the risks arising from its liabilities. Under the company's hedging policy, the purpose of the hedging is to even out risk concentrations, lower the total risk and reduce the capital tied up in the liabilities. Under the company's policy, hedging is a secondary measure and may not justify risk taking. The risk to be hedged against must be acceptable when taken. Reinsurance is the most important hedging tool.

Finnvera can apply special risk taking in risks that exceed the ordinary risk limits stated in the company's credit and guarantee policy. Special risk taking is used by the state owner to steer Finnvera towards riskier activities that are also more beneficial to the state in such areas as labour market policy.

To manage risk taking and to communicate on it, the company's board has approved a document on risk appetite in which a number of indicators are used to define the limits for imputed losses and concentrations approved by Finnvera. The purpose of the limits is, together with the principles governing capital management, to ensure that risk remain manageable with existing capital buffers. The practice was introduced in 2016. The overall risk-taking limits set out in the risk appetite document may also be exceeded.

No risk assessment was carried out when the Arava loan scheme was abolished

The changeover in the National Housing Fund from Arava loans to guarantees and subsidised loans was based on the Government Programme of Prime Minister Matti Vanhanen's second government. The impact of the changes on risks was not assessed in the Government Programme. The changeover was carried out in the 2008 state budget, in which Arava loans were no longer included as a scheme to subsidise housing construction. This means that new Arava loans are no longer granted. The risk aspect was not considered in the Government proposals submitted to Parliament as part of the 2008 state budget. Low demand for Arava loans was the only justification given.

The impacts of the changeover from Arava loans to subsidised and guarantee loans has not been adequately considered in the risk assessment

Under the risk management guidelines for social housing financing used by the board of the National Housing Fund, the State Treasury and ARA shall jointly produce a twice-yearly risk report on state-subsidised housing loans and government guarantees. The risk report must contain details of trends in payment delays and credit losses, breakdown of the loan portfolio in accordance with the credit risk models, assessment of risk concentrations, description of new lending and support measures already carried out, as well as trends in non-performing loans. The report must also contain an assessment of the National Housing Fund's risk management status and a description of the measures taken to improve risk management.

According to the audit findings, the risk reports contain all the above information on Arava loans. The reporting on guarantee and subsidised loans is on a more cursory basis than that on Arava loans. With regard to guarantee and subsidised loans and when compared with the guidelines, the main inadequacies in the reporting concern the breakdown of the loan portfolio and the assessment of risk concentrations. These are completely absent from the reports. Only the credit risk is assessed in the risk report. The interest rate risk arising from subsidised loans is not discussed in this connection. An assessment of the interest rate risk is, however, included in the final accounts of the National Housing Fund. According to the assessment, at an interest rate of five per cent, the costs during the entire payment period of the interest subsidies applying to the existing loan portfolio would total EUR 1,729 million.

The assessment describes the costs in a situation where there is a substantial rise in interest rates. However, it does not give a comprehensive picture of the interest rate risk at different interest rate levels. The picture given of the interest rate risk could be expanded by providing a number of alternative calculations at different interest rate levels.

Appendix: Audit method

This appendix describes how the findings presented in the audit were produced and what are the limitations concerning the findings.

Audit objective and use of the audit findings

The purpose of the audit was to assess the management of the growing portfolio of general government contingent liabilities and to evaluate the capability of general government to manage them. The main question of the audit concerned whether the management of general government contingent liabilities is adequately taken into account in the drafting and steering of fiscal policy. The audit question was approached with three sub-questions in which the purpose was to determine whether fiscal policy steering contains elements that aim to regulate the growth in contingent liabilities, whether a true and fair picture of the general government contingent liabilities is given and where the risks arising from the contingent liabilities to the state are assessed.

The audit findings can be used in the work to develop the reporting on contingent liabilities, decision-making information base and liabilities management practices.

Audited entities

In the audit, the focus was on government guarantees and (at reporting unit level) on general government entities. The Ministry of Finance, Ministry of Economic Affairs and Employment, Ministry of the Environment, Finnvera Plc, the Housing Finance and Development Centre of Finland, and the lending unit of the State Treasury and their activities were reviewed in the audit.

Opinions on the draft audit report were requested and received from the Ministry of Economic Affairs and Employment, Ministry of the Environment, Ministry of Finance, Finnvera Plc, the Housing Finance and Development Centre of Finland and the State Treasury. The feedback contained in the opinions was taken into account in the preparation of the final audit report. The opinions and the abstract based on them can be viewed on the website of the National Audit Office.

Audit questions, criteria, material and methods

The audit questions, criteria, material and methods are briefly described on the next page. At the preliminary review stage, comments on the audit plan were requested from the Ministry of Finance. The Ministry of Finance did not propose any changes to the audit design.

Audit issues and sub-issues

1. Is the management of general government contingent liabilities adequately considered in the drafting and steering of fiscal policy?

Audit criteria, material and methods

Interpretation: Giving adequate consideration to the management of contingent liabilities means that a true and fair picture of the contingent liabilities is given. This means that the impacts of contingent liabilities on the financial position of central government and changes in it are presented. Giving adequate consideration also means that the impacts of contingent liabilities are presented from the perspective of the sustainability of financial management. This means that the long-term impacts of contingent liabilities (on revenue, expenditure and financial position) are presented, the information base connected with them is reliable and the grounds for the decisions are presented in a transparent manner. Adequacy of the management is also reviewed from the perspective of the proper central government financial management. In a fiscal policy audit, this is considered to include performance and effectiveness or the achievement of policy goals and adherence to the principles of good governance in the drafting and implementation of fiscal policy. Proper central government financial management also comprises responsible financial management, which means that all long-term impacts are openly presented in the drafting process and in the decision-making.

1.1 Does fiscal policy steering contain elements the aim of which is to regulate the growth in contingent liabilities?

Criteria: Requirements for the information content laid down in the European Union law and the national legislation

Documents: Regulation (EU) No 1175/2011 of the European Parliament and of the Council amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies. Council Regulation (EU) No 1177/2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure. Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States (Budgetary Frameworks Directive).

Analysis methods: Content analysis of the documents

1.2 Is the picture given of the contingent liabilities true and fair?	Criteria: Budget legislation. Requirements for the information content laid down in the European Union law and the national legislation. Manual on Fiscal Transparency and Fiscal Transparency Code of the IMF. Material: State Budget Decree (1243/1992), Budgetary Frameworks Directive, Government's annual reports (2012-2016), Overviews of Central Government Risks and Liabilities (2015-2017), General Government Fiscal Plans, information published under the Budgetary Frameworks Directive Analysis methods: Content analysis of the documents
1.3 Are the risks arising to central government from the contingent liabilities assessed?	Criteria: Instructions for drafting Government proposals, Ministry of Justice guidelines on assessing the impacts of legislative proposals, State Budget Act (432/1988), Act on the State-Owned Specialised Financing Company (443/1998) Material: Government proposals (243/2016), (44/2015) and (58/2014), Overviews of Central Government Risks and Liabilities (2015-2017), state budgets (2015-2017), risk management documents prepared by Finnvera and the National Housing Fund Analysis methods: Content analysis of the documents

Audit process

The audit was performed between 11 January 2017 and 26 January 2018. The interviews were conducted between 24 April and 18 May 2017. Changes taking place in the audited entities have been considered up to 13 January 2018.

Auditors

The audit was carried out by Principal Performance Auditor Vuokko Mustonen, Principal Fiscal Policy Auditor Mika Sainio and Audit Assistant Juha-Matti Tölli. The audit as supervised by Director for Fiscal Policy Audit Matti Okko.

Limitations and reservations concerning the audit findings

The correctness of the assessment of the risk arising from the liabilities presented by the audited entities or the impacts of the risks arising from contingent liabilities on central government financial position and changes in it were not reviewed in the audit.

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