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New decision of Eurostat on deficit and debt

Classification of funded pension schemes in case of government responsibility or guarantee

Eurostat, the Statistical Office of the European Communities, has taken a decision on the classification of some funded pension schemes where government is involved either as a manager of the flows of contributions and pension benefits or as a guarantor for the risk of defaulting payments of pensions. This decision does not cover the schemes organised by employers for their own staff (including specific schemes for civil servants organised by government).

The decision specifies the cases where a pension scheme should not be treated as a social security scheme, with the consequence that the flows of contributions made to the scheme and of pension benefits paid by the scheme are not recorded as government revenue or as government expenditure and, therefore, do not have an impact on government deficit or surplus (EDPB9). This decision results from work undertaken in 2003 in cooperation with experts from European countries and different international bodies.

This decision is in line with the European System of Accounts (ESA95) and is consistent with the opinion of the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB), as described in annex.

Among pension schemes that may be managed by government, a defined contributions funded scheme cannot be classified as a social security scheme

In national accounts (ESA95), there is a distinction between two types of pension schemes that are sets of rules relating to the coverage of the "old age" risk through a social insurance arrangement. Schemes can be "unfunded" or "funded".

In an "unfunded scheme" (frequently referred to as "Pay as you go systems") one unit is "responsible" for the unconditional payment of the pensions and, therefore, takes the financial risk of payment of the benefits. The accumulation of some reserves may be observed, but there is no intention to use invested assets as a major source of resources for the payment of the future pensions. ESA95 provides clear rules as regards the conditions for classifying such schemes as "social security schemes" in cases where a government unit is responsible for the management of an unfunded scheme.

A funded scheme is an arrangement where there is an accumulation of assets, mainly financial assets, from contributions, with the objective of ensuring all or a major part of payment of the future benefits from these assets.

A first category of funded schemes are "defined-benefits funded schemes" where, although there is an accumulation of assets as mentioned above, a unit bears a financial risk as it takes the commitment to pay a promised level of benefits irrespective of the value of the accumulated assets. A government unit may manage such defined benefit funded schemes, although this is not very frequent at present. ESA95 provides clear rules as regards the conditions for classifying such schemes as "social security schemes" in cases where a government unit is responsible for the management of a defined benefit scheme and, therefore, bears the financial risk attached to the scheme.

A second type of funded pension scheme is usually called "defined contributions funded schemes". In this case, the individual pension benefits depend on the accumulated assets but the level of the future pensions is uncertain as individual households bear the whole financial risk attached to the invested assets from the accumulated reserves. ESA 95 needed clarification on this issue.

Eurostat has decided that if a government unit is responsible for the management of a defined contributions funded scheme, for which there does not exist any government guarantee for the risk of defaulting payments covering the majority of the participants, the scheme cannot be treated in national accounts as a social security scheme. The unit managing the scheme must be classified as a public financial corporation. Therefore, the flows of contributions and benefits under the scheme are not recorded as government revenue or expenditure and do not have an impact on government deficit or surplus.

According to this decision, all pension funds where the participants bear the financial risk should be treated in the same way, whatever the nature - public or private - of the unit managing the scheme, or the obligatory or voluntary nature of the scheme. Where the manager is a government unit, it is clear that this unit is not acting for public policy

purposes but, similarly to a financial institution, is managing funds on behalf of households, who hold a legal claim on the scheme reserves. The funds cannot be used for any other purpose than ensuring payments of pension benefits. Because of that, the flows relating to this kind of scheme must be separated from other government expenditure and revenue.

Where a government unit simultaneously manages two kinds of schemes, one unfunded and the other funded, two different institutional units must be distinguished in national accounts.

This part of the decision refers to the cases of "mixed or hybrid schemes" where a government unit is involved simultaneously in flows related to different kinds of schemes. On the one hand, it collects contributions and pays benefits under a "pay-as-you go" system and, on the other hand, it receives funds from households and/or employers that are invested on markets, such that individual benefits, for that part, will predominantly depend on the invested assets. Each particular scheme may concern different categories of agents (for example the funded scheme is reserved for new participants or subject to age conditions) or both schemes may concern all members together. The corresponding flows, relating to two different sets of rules (notably as regards the financing of the pension benefits) are fully identifiable.

Eurostat has decided that in such situations two different institutional units must be distinguished, each of them referring to one identifiable scheme. The corresponding flows under each scheme should be recorded according to the sector classification of the unit responsible for the scheme. If one unit is classified outside the general government sector, which would be the case if the unit is responsible for the management of a defined contributions funded scheme, the flows of contributions made to the scheme and the flows of benefits paid from the scheme will not be part of government revenue or expenditure and therefore will have no impact on government deficit or surplus.

The existence of a government guarantee to a scheme not classified as a social security scheme is not as such a condition for reclassifying the beneficiary scheme as a social security scheme

In order to reduce uncertainty for participants in a scheme that is not classified as a social security scheme, government may make a commitment to act as the payer of last resort in the case of any default in payment of pensions, including an insufficient level of accumulated reserves. This has the effect of offsetting all or a very large part of the financial risks borne by all the participants in the scheme or only by the institutional unit "responsible" for the scheme. This guarantee would assure that benefits reach a given level.

The case under review here is where the guarantee is put into force for a majority of participants, and not only for those who could be in a disadvantageous position, notably by reference to a minimum revenue granted under social assistance provisions. This guarantee should also be explicit, and different from any "general commitment" taken by government as a result of its leading role in the system of social protection in a country, such that it has the mission to ensure a minimum standard of living for inhabitants, both through an "appropriate and sustainable" social protection system and through interventions for social assistance.

Such guarantee may cover any kind of schemes: unfunded and "defined benefit funded schemes" (government financial resources assure payment of promised benefits in the case of insolvency of the unit that has taken the commitments to ensure the payments) as well as "defined contributions funded schemes" (government resources compensate "bad performance" on markets affecting a significant part or all participants).

Eurostat has decided that the existence of a guarantee, under the conditions mentioned above, is not a sufficient condition for classifying the scheme as a social security scheme. The government guarantee must be considered as a contingent liability, not recorded in national accounts as a government liability according to the general ESA95 principles. In this respect the risk borne by government is only a potential one as it depends on the occurrence of certain specific events.

However, under certain conditions, a scheme that has been granted a government guarantee could be reclassified as a social security scheme.

An obvious condition is where there is a recurrent call on the guarantee during several fiscal years, such that it is obvious that government's support to the scheme is not implemented for exceptional and temporary reasons, but is motivated by a noticeable default in sustainability. Generally, government might take full control of the scheme and adjust the levels of contributions and of benefits.

Such reclassification might also occur even before any effective call if there is strong evidence (based on the opinion of independent experts) that, in the next few years, it would be quite certain that the guarantee would be called and payment of benefits will come mainly from government financing.

However, in both of the above cases, a pension scheme should be reclassified as a social security scheme only when it is evident that government will ensure the payment of more than 50% of the actuarial value of the pensions from its own resources, in the case of unfunded or defined benefit funded schemes, and where government ensures the payment of benefits for a part higher than the one paid from the assets accumulated in the fund, in the case of defined contributions funded scheme.

This is a framework decision taken in the context of the principles for the classification of certain types of pension schemes. Within this framework decision, individual cases in Member States will be analysed bilaterally during the following weeks.

Eurostat will include in the ESA95 Manual¹ for government Deficit and Debt a new chapter explaining, with numerical examples, the above-mentioned treatment of pension schemes managed by government or granted a government guarantee. In cooperation with Member States, Eurostat will also elaborate proposals in order to clarify ESA95 as regards the classification of funded pension schemes.

1. The PDF version of the ESA 95 Manual on government deficit and debt is available for free download from the Eurostat Website. [ESA 95 Manual](#)

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CMFB opinion
on the classification of (autonomous) funded social insurance pension schemes in ESA95 (excluding schemes operated by employers for their own employers)

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The CMFB Chairman, with the assistance of the Executive Body, invited the CMFB Members on 5 February 2004 to give an opinion on the above-mentioned subject, in the form of a questionnaire including three questions. Fifteen (15) national statistical institutes and fourteen (14) national central banks from the Member States returned the questionnaire. A total of twenty-nine (29) national institutions thus participated in the consultation. The ECB also provided a reply.

The result of the consultation was the following:

On the question related to the effect of an explicit guarantee granted by the government to an autonomous funded social insurance pension scheme for any risk of defaulting payment of pensions for at least the majority of the participants in the scheme, *Fifteen (15) national institutions considered that the existence of this single guarantee as such is not a sufficient condition for classifying the scheme as a social security scheme.* Several of these institutions mentioned that additional criteria should be considered, including whether the guarantee has been frequently called or is likely to be called in the future. Ten (10) national institutions considered that the existence of this single guarantee is as such already a sufficient condition for classifying the scheme as a social security scheme. Four (4) national institutions did not express a preference as regards this issue.

On the question related to a defined-contribution funded scheme where a government unit is responsible for the management but where government provides no guarantee for the risk of defaulting payments of pensions for the majority of the participants, *Eighteen (18) national institutions responded that the unit responsible for the management of such schemes should not be classified within government sector and that the flows of contributions made to the scheme and of pensions paid from the scheme will thus have no impact on government expenditure or revenue.* Eight (8) national institutions considered that such a unit should be classified in the government sector and that the scheme should be treated in national accounts similarly to any other social security pension scheme. Three (3) national institutions did not express a preference as regards this issue.

On the question related to the treatment of "mixed schemes" with two parts, the corresponding flows of contributions and benefits being clearly identifiable, *Eighteen (18) national institutions agreed that in national accounts two different units should be distinguished.* Nine (9) national institutions considered that only one institutional unit should be recorded in the system and classified according to its predominant features. Two (2) national institutions did not express a preference as regards this issue.

Accordingly, the CMFB provides the following opinion on the classification rules that were proposed for specific issues related to social insurance pension schemes.

- A guarantee provided by the government is not a sufficient condition for classifying a scheme as a social security scheme. Other criteria must be considered as well.

- A defined-contributions funded scheme, where government provides no guarantee for the risk of defaulting payments of pensions for the majority of the participants, should not be treated as a social security scheme.

- In a mixed scheme where two parts (one is funded, the other one unfunded) are identifiable as

far as the flows of contributions and benefits are concerned, i.e. if both of them have a complete set of accounts, two separated institutional units should be distinguished.

The CMFB recommends that those opinions and the clarifications provided by national institutions with their answers, notably as regards the effect of government guarantees, should be incorporated in a new Chapter of the ESA95 manual on Government Debt and Deficit concerning the treatment of pension schemes.

In addition to this opinion, a document summarising the replies and all the original answers from the CMFB Members have been transmitted to Eurostat and will be kept in the records of the CMFB secretariat.

Jean CORDIER
CMFB Chairman

(Signed)

Paris, 14 February 2004