EUROPEAN COMMISSION
EUROSTAT

Directorate D: Government Finance Statistics (GFS)

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Decision of Eurostat on government deficit and debt

The statistical recording of an unbalanced transfer of pension obligations to government under ESA 2010

1. Introduction

This note provides Eurostat's decision on the treatment, under ESA 2010, of an unbalanced transfer of pension obligations into a social security system. This decision does not concern data under ESA 1995, and will be only applicable for all data transmitted under ESA 2010, from September 2014 onwards.

This decision is made in accordance with the process defined by Article 10.2 of Regulation 479, as amended. The opinion of the Committee for Monetary, Financial and Balance of Payments Statistics (CMFB) was sought. This is included in annex. In this specific case, however, this expert advisory group could not provide an opinion. The case of unbalanced transfers described in this note needs nevertheless guidance, which is provided herewith. This guidance is consistent with the recommendation of the world wide national accounts manual, the SNA 2008.

2. The issue

In several Member States, institutional units, including private corporations, public corporations and government entities, may set up specific pension schemes for their own staff. For various reasons, government may take over these pension obligations incurred, in most cases, by a corporation under government control (thus, classified in the public sector as a public corporation) but also possibly by private corporations under some specific circumstances. Examples include plans for (total or partial) privatisations or new stock market quotations. Government, as the owner of the public corporations (or in the context of a support to a private corporation), may wish to improve the financial situation of the corporation by removing liabilities from their balance sheet. For instance, in the case of a planned privatisation, investors may be reluctant to purchase the equity of a corporation encumbered with pension obligations, most notably in the case of under-funding (where the assets of the scheme have a lower value than its future obligations and the employer has a commitment to bridge the gap).

At the time of the transfer of the pension obligations to government, the corporation has to pay (possibly by instalments over a given period of time) a lump sum (usually in cash or under the form of other financial assets, such as securities) in order to compensate government for becoming responsible for the future payment of pensions (usually both for people already retired and future beneficiaries still in activity).

Under ESA 2010 (see 20.273-275), and contrarily to ESA 1995, this lump sum is considered as a financial transaction with no impact on government net lending / net borrowing.[1] The transfer of the assets is counter-balanced by a liability (recorded as "other accounts payable"). This must be viewed as a financial advance, the prepayment of social contributions.

This decision refers to the case where the employees of the corporation will be subject in the future to the "normal" Social Security scheme obligations, based on a "PAYG" system. Under ESA 2010, the pension obligations related to a Social Security schemes are not recorded under a specific financial instrument, which would be a liability of the general government and an asset of the households sector.

3. The decision

In all those cases, which had been observed in the past only exceptionally, where there is evidence that government has not received enough assets in exchange for taking over pensions obligations from the corporation, either because, on the basis of the usual estimation methods, the pension liabilities are under-estimated, or because the total value of the assets transferred are below the recognised present value of such pension entitlements, ESA 2010 must be completed by a specific guidance, as this case is not mentioned in ESA 2010.

Eurostat has decided that any difference between the amount of liabilities transferred to the government and the value of all assets transferred as compensation, will be recorded as a capital transfer, with an immediate impact on government net lending / net borrowing, at the time of the transfer of the pension obligations to the social security system. This negative impact at the time of the transaction will implicitly be compensated in the future years by imputed revenues.

It is important to note that the amount of liabilities transferred to the social security system may not be the original pension liability of the corporation, if the transfer is accompanied by a change in the pension obligations towards current or future pensioners. In this case, it is the new amount of liability which is to be used in the calculation of the capital transfer.

It is also to be noted that, in accordance with section VII.2.2.2.2 of the Manual of Government Deficit and Debt, no capital transfer will be normally recorded in case the transfer occurs during a privatisation process.

Finally, the estimated amount of the transferred pension liabilities is based on an actuarial model, which uses assumptions. The estimate of the capital transfer should be based on the best available estimate, approved by recognised actuaries.

[1] With the exception of non-financial assets (such as buildings) which might be transferred as compensation payments in kind.

4. The rationale of the decision

As a general principle, in national accounts, when government carries out unequal transactions, by evidence not for “purely commercial reasons”, which would imply equivalence between the two legs of the transaction, a capital transfer is to be recorded.

In the case of transfer of pension obligations, Eurostat considers that whatever the way the transaction is recorded under national accounts, when government takes the responsibility for the future payments of pension to the employees of a corporation, the difference between the increase in the new government commitments and the value of the assets received in return has to be recorded as a capital transfer to the corporation.

In this case, Eurostat considers that government has not undertaken the transaction with the aim to receive a full compensation for the obligations taken over. It has deliberately accepted to enter in a transaction in which there is, by evidence, an unrequited gift element. This is to be considered, in particular, as a support from government to the corporation, which must be recorded as such in national accounts. The net worth of the government would be negatively affected, and the net worth of the corporation involved in the transaction would be positively affected.

5. Entering into force of Eurostat’s decision

From September 1st 2014, ESA 2010, approved in May 2013 by the EU Parliament and the EU Council (Regulation 549/2013), will enter into force. Therefore, this decision will be applicable only at this date for all data (including historical data), under ESA 2010.

ANNEX

CMFB
COMMITTEE ON MONETARY, FINANCIAL AND BALANCE OF PAYMENTS STATISTICS

CMFB opinion on

Unbalanced transfers of pension obligations to the government under ESA10

1. At Eurostat's request, I as the CMFB Chairman, with the assistance of the CMFB Executive Body, asked CMFB Members on 18 October 2013 to express their opinion on the recording in government accounts of unbalanced transfers to government of pension obligations. The deadline for replies was 4 November 2013. Twenty-four (24) national statistical institutes, twenty-two (22) national central banks and the ECB returned the questionnaire within the specified time. A total of forty-seven (47) institutions provided their opinion.
2. In this consultation, the respondents were provided with two alternative recording options for the value of the AF 89 liability, as follows (A): the estimated value of the transferred pension liabilities, according to the agreed actuarial calculations, together with government expenditure - capital transfer - at the time of the transaction corresponding to the value of the under-funding, or: (B) the value of the assets effectively transferred by the corporation to the government (ignoring the value of the under-funding).
3. Both recording options received exactly the same number of expressions of support from the respondents. The respondents who supported option A mainly argued that it is the best reflection of the economic substance of such transactions. As the corporation transferring its pension obligations has an improved financial position after the transaction, a capital transfer from government should be recorded at the time of the transfer for the value of the under-funding. Those who supported option B mainly did so for reasons of equal treatment between the transferred liabilities and the liabilities already in the social security system and of ease of recording. They furthermore argued that the actuarial calculation could pose problems.
4. Based on the balanced outcome of the consultation, the CMFB cannot express a firm opinion on this issue.
5. In addition to this opinion, all of the anonymised answers from CMFB Members have been transmitted to Eurostat and will be kept in the records of the CMFB secretariat.

(Signed)

Joe Grice
CMFB Chairman

Newport, 18 November 2013