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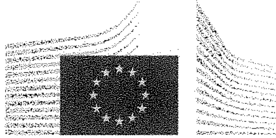

EUROPEAN COMMISSION
EUROSTAT

Directorate D: Government Finance Statistics (GFS) and quality

Luxembourg,
ESTAT/D-1/EBC/LA/TF/gh/ D(2016) 5566819

Dr. Konrad Pesendorfer
Director General
Statistics Austria
Guglgasse 13
A-1110 Vienna
Austria

Subject: Request for ex-ante advice

Statistical treatment of the planned transfer of pension obligations

Ref.: Your Email of 22 July 2016

Dear Mr. Pesendorfer,

Thank you for your email dated 22 July and the attached documentation providing a description of the planned transfer of pension obligations from the [redacted] to the [redacted].

(1) THE ACCOUNTING ISSUE FOR WHICH A CLARIFICATION IS REQUESTED

The statistical authorities of Austria have informed Eurostat that the [redacted] ([redacted] government) is considering a transaction with the [redacted] involving the transfer of pension obligations of the latter to the former. A final decision on the intended transaction has not yet been reached. In this context, the statistical authorities of Austria were asked by the [redacted] to provide their view on the recording of this transaction in national accounts and, in particular, on its possible implications on the EDP deficit and debt data. Given the size of the planned transaction, the statistical authorities of Austria also asked Eurostat to assess the accounting issues at stake and express its opinion.

Documentation provided

The statistical authorities of Austria provided (1) a description of the possible transaction, of the potential amounts involved and of the issues leading to the planned transaction prepared by the [redacted], (2) the expert reports submitted to the European Commission for the state-aid examination procedure and (3) a detailed analysis of the accounting treatment and impact on the EDP deficit and debt data, prepared by the statistical authorities.

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Description of the case

The [redacted] was converted into a holding structure in [redacted]. Before the reorganisation, the group companies were the so-called "Wirtschaftliche Unternehmungen" which have been considered as market producers (quasi-corporations) by the Austrian statistical authorities. They were recognized on a net basis in the accounts of the [redacted]. The [redacted] is wholly owned by the [redacted], [redacted]. The civil servants that worked for the [redacted] were seconded to the newly established [redacted]. Furthermore, the [redacted] Act [redacted] requires the [redacted] to reimburse the [redacted] for the pension-related expenses for the civil servants (and their dependents) seconded to work for it. According to this established obligation, section 211 (2) of the Austrian Commercial Code requires the [redacted] to recognise these direct pension liabilities in its balance sheet. The provisions for the pensions recognized in the balance sheet of the [redacted] are compiled in the same manner as the liabilities for a defined benefit scheme in a national accounts context. However, the secondment of the civil servants to the [redacted] does not affect the salary related rights and obligations as well as the pension related legal provisions between the civil servants and the [redacted].

The planned transaction between the [redacted] and the [redacted] intends to release the first party from the pension obligations for the civil servants and to transfer these obligations to the second party. The considered transfer does not cover all pension obligations of the [redacted] and includes only those recognised for the [redacted]

The pension obligations to be transferred to the [redacted] consist not only of the accrued-to-date liabilities (ADL) of the current civil servants (value of actual pension obligations) but also of the currently seconded civil servants' pension obligations accruing in the future. Although there is no separation of the two parts available, the statistical authorities of Austria considers that the part of the pension obligations that will accrue in the future will be clearly the smaller part [redacted]
According to the documentation provided, the present value of the combined pension obligations is calculated at [redacted] euro by using a discount rate of 2.6%.

One counterpart of the transfer of the pension obligations is the issuance of several loans carrying fixed interest between 2.15% and 2.8%. All loans together add up to an amount of [redacted] euro (with an average interest rate of 2.25% and a 30 year initial maturity). The [redacted] and the [redacted] agreed that the operating results of the group companies concerned by the potential transfer of the pension obligations would be paid in the amount necessary to cover the actual annual pension payments (i.e. dividend payment equals to pension payments less reversal of the lump sum payment (loan component), less interest payments on the loans) to the [redacted] (dividend payments or withdrawal of equity in national accounts) until [redacted]. However, the dividend payments are not fixed in advance but will depend on the future dividend policy of the [redacted]. The planned operation, at inception, does not involve the provision of currency or deposits neither by the [redacted] nor by the [redacted]. The existence of the new loan liability in the balance sheet of the [redacted] is de facto due to a conversion of the receivable against the group companies for the present value compensation" of the pension obligations.

Analysis by Statistics Austria

The statistical authorities of Austria conclude that the intended transfer of pension obligations would result in the recognition of an equity asset (AF.52) amounting to [redacted] euro, a loan asset (AF.42) amounting to [redacted] euro and other accounts payable (AF.89) amounting to [redacted] euro on the government's balance sheet appearing through transactions. The latter represents the counterpart accounting entry for the loan asset (lump sum). For the equity asset no other accounts payable has to be recognized, implying that the net financial worth of the [redacted] has increased after the transfer of the pension obligations.

Moreover, the statistical authorities of Austria concluded that no one-off capital transfer has to be recorded in the year of the transaction (i.e. the transfer of the pension obligation is balanced) and that the future impact on the net lending/net borrowing of the [redacted] is largely unchanged. The latter partly because of the fact that the future pension payments will be generally covered by revenues from miscellaneous current transfers (see above), interest payments for the loan and dividend payments received from the group companies.

(2) METHODOLOGICAL ANALYSIS AND CLARIFICATION BY EUROSTAT

Applicable accounting rules

- ESA 2010, Chapter 20, in particular, paragraphs 20.273 to 20.275 dealing with the issue of lump sum payments in exchange for taking over pension obligations; paragraphs 20.198 to 20.200 on capital injections and paragraphs 20.205 to 20.207 on public corporations distributions as well as paragraphs 20.222 to 20.229 on debt assumptions and cancellation.
- Decision of Eurostat on government deficit and debt - The statistical recording of an unbalanced transfer of pension obligations to government under ESA 2010 of 22 November 2013: http://ec.europa.eu/eurostat/documents/1015035/2041337/ESTAT-decision-Unbalanced-transfer-pension-oblig-to-gov-.pdf/59626494-9049-47eb-aa63-077989eb3e37
- The Manual on Government Deficit and Debt (MGDD), implementation of ESA 2010, 2016 edition:
  Part III.2 'Capital injections into public corporations'
  Part III.5 'Dividends, super-dividends, interim dividends'
  Part III.6 'Impact on government accounts of transfer of pension obligations'
  Part VII.2 'Debt assumption and debt cancellation'

Analysis

Eurostat takes note that the legal responsibility for the pension obligations of the seconded civil servants remained with the [redacted]. Nevertheless, from an economic point of view, the [redacted] effectively bears the responsibility for the pension obligations owing to the provisions of the [redacted] Act, which form part of national legislation. The [redacted] now intend to transfer back the economic responsibility for the pension obligations to the [redacted].

Eurostat is aware of the fact that the intended transfer of pension obligations involves not only accrued-to-date pension liabilities but also pension obligation which will accrue in the future to the current workers of the [redacted]. The following analysis does not make any distinction between those pension liabilities which are already accrued and those which will accrue in the future. Instead it focuses on the substance of the planned transaction. Conceptually, the intended transfer of pension obligations constitutes a transfer from an

unfunded employer scheme to an unfunded scheme under the responsibility of the [redacted]. In ESA 2010, unfunded pension liabilities of government are contingent liabilities. In case of a transfer of pension liabilities, an other accounts, payable is recognised for government, which decreases in line with actual pension payments.

The key point is whether the [redacted] has received a lump sum payment or other assets which can be considered as an appropriate compensation for the assumed pension obligations in the amount of [redacted] euro (see ESA 2010 paragraph 20.273). The planned transfer of the pension obligations to the [redacted] is not a simple balanced transfer of pension obligations (i.e. provision of a lump sum payment in cash as compensation for the assumption of future pension payments). Instead, the [redacted] receives several loan assets (in total [redacted] euro) in exchange for assuming a pension obligation at a present value of [redacted] euro. The first issue concerns the question of whether the provision of the loan assets by the [redacted] could be considered as equivalent to a lump sum payment in cash, as mentioned in the standard case in ESA 2010. The second issue to be examined is whether the transfer is to be considered as neutral on financial net worth and net lending/net borrowing, as described in ESA 2010 paragraph 20.274 and in the Eurostat decision of unbalanced pension liability transfers or not.

The simple balanced case mentioned in ESA 2010 paragraph 20.273 indicates that the usual lump sum payment is a one-off cash payment (not however excluding other possibilities); moreover MGDD chapter III.6.1.3 paragraph 9 clarifies that the lump sum has neither to be provided as a one-off amount nor a as cash payment. This paragraph recognises that the incurrence of a loan liability (or loan liabilities) may be viewed as a separate transaction, i.e. that a lump-sum deposit could be considered to be provided, neutralised by a reduction in deposits and incurrence of loan liabilities (partitioning). Against this background, the loan assets are a fairly straightforward case. While there is no provision of actual cash funds at the time of transaction, the loans, however, establish obligations to make regular cash payments (redemption and interest) to the [redacted] regardless of the performance of the [redacted]. The loans carry fixed interest rates between 2.15 % and 2.8 % and will be redeemed by the [redacted] in 30 equal annual instalments. In addition, there is evidence that the interest rates could be considered as normal market returns for such loans (e.g. rating of the company, lifetime of the loan). The new loan liability on the balance sheet of the [redacted], or vice versa the loan asset on the balance sheet of [redacted] is therefore, in substance, a suitable substitute for a lump sum payment in cash in order to compensate the [redacted] for the assumed pension obligations in the amount of [redacted] euro (see MGDD chapter III.6.1.3, paragraph 9).

The issue of the equity asset could be seen as less straightforward. From the business accounts perspective of the [redacted], the existence of the additional equity is basically the result of the removal of the pension obligations (partly replaced by a loan liability) previously recorded on its balance sheet, avoiding at the same time the transfer of assets or issuing a loan liability as compensation for the pension obligations transferred to the [redacted]. In essence, the whole arrangement could be considered as debt relief for the benefit of the [redacted] and the existence of the new equity is just due to the outcome of the revaluation of the equity (i.e. an accounting artefact).

However, from the national accounts perspective the situation could be seen as less apparent. The pension scheme operated by the [redacted] could be considered as an employment-related pension scheme resulting in the recognition of a AF.63 liability in its balance sheet for the accrued-to-date pension liabilities. However, these pension liabilities will disappear after the transfer to the [redacted], since its pension scheme is basically a PAYG scheme for which no AF.63 liabilities are recognized in national accounts. Conceptually, the AF.63

liability is therefore removed (other flow) from the balance of the [redacted] immediately before the actual transfer of the pension obligations takes place. The outcome of this approach is similar to the results in the business accounts. The pension liability disappears and the equity of the [redacted] increased (pension liabilities – loan liability) via revaluation and not by an actual transaction (capital injection in cash or in kind). In contrast to the business accounts, there is apparently no obvious release component in national accounts. In addition, there are no direct implications for government flows at the time. The question is, however, whether the artificial increase of the equity by revaluation and not by transaction could be considered as a capital injection and, moreover, be considered as a compensation for taking over the pension obligations.

ESA 2010 paragraph 20.200 take note of this accounting issue and explains that, '*...capital injections increase the own funds of the unit invested in, it is likely to also lead to an increase of the investor's equity stake in the invested unit. This is automatically the case of those 100% owned public corporations whose equity is the value of their own funds. Such an increase in equity is not used as a criterion to judge the nature of the capital injection; instead, it leads to an entry in the revaluation account when the injection is recorded as capital transfer* ... '.

Thus, an increase in equity does not in itself preclude the recording of a capital transfer under specific conditions. In fact, ESA 2010 paragraph 20.200 is basically introducing two reporting conventions for capital injections. The first convention is that a capital injection test has to be carried out in cases where a capital injection effectively takes place and has a direct impact on the equity of the beneficiary corporation (i.e. providing capital injections in cash or in kind). Depending on the outcome of the capital injection test, it is decided whether a transaction in equity or a capital transfer has to be recorded. The latter leads only to an indirect impact on the equity recognized on the balance sheet of the investor via revaluation. The second convention is that, in specific circumstances, when for example, a government unit assumes a part of the debt of a wholly owned public corporation, a capital transfer has always to be recorded in cases where government does not receive an already existing asset of the same value, regardless of the fact that, in such a situation, the value of the equity automatically increases in the amount of the liability removed from the balance sheet (see ESA 2010 paragraph 20.223 and 20.226). This is based on the assumption that there is an intended and voluntary transfer of wealth from government to the public corporation (see MGGD chapter VII. 2.3.1 paragraph 22).

Eurostat considers that that the increase in equity due to the transfer of pension obligations has not to be tested against the capital injection test but along the lines of the rules for debt assumption. Similar to the case of a debt assumption, the increase in equity is initially only an accounting artefact, resulting from removing the pension obligations and partially substituting them by a loan. By analogy with debt assumptions (see ESA 2010 paragraph 20.226) benefitting a public corporation *"an increase in the value of the equity in the unit being invested in"* should only be recorded in the revaluation accounts. Thus, the increase in equity (the equity exists from a pure revaluation impact) cannot be considered as adequate compensation (financial asset) for taking over the pension obligations by the [redacted].

Eurostat is aware of the fact that it could be expected that the value of the [redacted] will increase due to the transfer of the pension obligations and it should be therefore valued at a higher level in the balance sheet of the [redacted] and in financial accounts. However, this expected impact is not immediate, uncertain and of a different amount.

MGDD chapter III.2.3.2.3, paragraph 46 clarifies in such a case that a capital injection should be treated as a non-financial transaction if '*...government does not receive in exchange a financial asset of an equal value, and any possible effect on the government's equity is indirect,*

sometimes not immediate, uncertain and of a different size. This sort of payment is recorded as capital transfer (D.9)...'.

Eurostat considers therefore that any increase in equity occurring after implementation of the planned transfer, should occur as a result of revaluations (K.7, holding gains and losses) and not through transactions in equity.

As the [redacted], acquires a loan asset of [redacted] euro and incurs a liability in other accounts, payable, amounting to [redacted] euro, in accordance with ESA 2010 paragraph 20.275 and the Eurostat decision on unbalanced pension transfers, the transfer of the pension obligations to the [redacted] should not be considered as balanced. Effectively, B.9f due to the planned operation would amount to [redacted] euro. In the non-financial accounts, this should be reflected by a capital transfer, payable, amounting to [redacted] euro. The capital transfer reflects the gift element referred to in the above-mentioned Eurostat decision. The impact on B.90f may be less than that on B.9f due to any revaluation effect on equity in [redacted]. This is provided for by MGDD chapter III.6.2.1 paragraph 13, taking up the provisions in the Eurostat decision on unbalanced pension transfers.

As regards the amount of the other accounts, payable (AF.89, financial advance, prepayment of social contributions) that has to be recognized in national accounts through a transaction, the total amount has to be equal to the amount of the estimated present value of the pension obligations transferred to the [redacted] (i.e. [redacted] euro). This amount should be amortised in the form of imputed revenue (D.759) which is offsetting the actual pension payments for the civil servants seconded to the [redacted]. The reduction of the financial advance needs to follow the scheduled pension payments. Furthermore, the imputed revenues (D.759) should be recorded on a gross basis; i.e. no netting against the interest revenues resulting from the loan and any potential dividend revenues paid by the [redacted] should be carried out. The latter are also subject to the super-dividend test allowing to separate dividend payments from a withdrawal of equity.

(3) CONCLUSION

Eurostat considers that the planned transfer of pension obligations should be treated in the following way

- the transfer of the pension obligations is not balanced, in the sense that the [redacted] would not receive a full compensation for taking over the pension obligations of the [redacted]. Whereas the loan asset is considered as an appropriate compensation (lump sum payment), an increase of the value of the equity in [redacted] group arises only through a revaluation. Therefore, a capital transfer amounting to [redacted] euro has to be recorded at the time of the actual transfer of the pension obligations.

- In national accounts, the total transaction in other accounts, payable, equals the present value of the pension obligations actually transferred (i.e. [redacted] euro).

- The future imputed revenue (D.759, financial accounts counterpart is a negative F.89 liability transaction) which is balancing the actual future pension payments (financial accounts counterpart is a reduction in F.2 assets) cannot be netted against the interest cash flows (D.41) resulting from the loan asset and the possible future dividend payments of the [redacted]. Instead, the imputed revenue (D.759) should be recorded on a gross basis. In addition, dividend payments have to be tested for super-dividends.

(4) PROCEDURE

This preliminary view of Eurostat is based on the information provided by the Austrian authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view.

We would like to remind you that Eurostat is committed to adopting a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009 and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat intends, therefore, to publish all future official methodological advice (ex-ante and ex-post) given to Member States, on the Eurostat web site. In case you have objections concerning this specific case, we would appreciate if you let us know. In any case (regardless of whether you have objections or not), we would like to receive an answer from you on the issue no later than 20 September 2016.

Yours sincerely,

(e-Signed)

Eduardo Barredo Capelot
Director

Electronically signed on 08/09/2016 13:36 (UTC+02) in accordance with article 4.2 (Validity of electronic documents) of Commission Decision 2004/563

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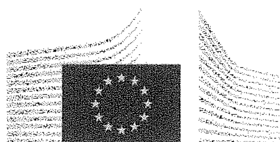

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Dr. Konrad Pesendorfer
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Subject: Statistical treatment of the planned transfer of pension obligations

Ref.: Your Emails of 22 July 2016 and 14 October 2016, our letter of 8 September 2016

Dear Mr. Pesendorfer,

Thank you for your email dated 14 October 2016 which is providing updated information on the planned transfer of pension obligations from the ████ to the ████. We take note that essential elements of the planned transaction have been changed - although the principal idea remains - following our first analyses of the issue provided to you on 8 September 2016.

The original plan had foreseen that the pension obligations of some group companies of the ████ were to be assumed by the ████, whereby the latter should be compensated for taking over these pension obligations. The intended compensation should have consisted of a loan asset (AF.42) amounting to ████ euro and an equity asset (AF.52) amounting to ████ euro. In addition, the recognition of other accounts payable (AF.89) amounting to ████ euro was being perceived as the counterpart accounting entry for the loan asset (the lump sum payment), reflecting the fact that the lump sum payment should be regarded as a prepayment of social contributions. In its letter of 8 September 2016, Eurostat expressed the view that this compensation mechanism, in particular the equity asset, could not be considered as being in line with the relevant provisions of ESA 2010 and the Manual on Government Deficit and Debt regarding the transfer of pension obligations. Therefore, a capital transfer equal to the amount of the equity asset had to be recorded under these conditions.

According to the information provided by Statistics Austria, the updated plan envisages material changes in the compensation mechanism without changing the other parameters or the original planning, in particular the amount of pension obligations (████ euro) to be

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transferred to the [redacted]. Now, however, the compensation (lump sum payment) consist of (1) a cash payment of [redacted] euro and (2) a loan asset (AF.42) amounting to [redacted] euro. Moreover, the other accounts payable (AF.89) recognized equals now the present value of the pension obligations actually transferred to the [redacted]. The loan asset is de facto a portfolio of loans carrying fixed interest rates between 2.39 % and 2.67 % and an average duration of 15 years (maximal maturity up to 38 years).

The one-off cash payment provided by the [redacted] meets the basic notion of a lump sum payment mention in ESA 2010 paragraph 20.273 and the loan part may be viewed as a separate transaction, i.e. it could be considered that a lump sum deposit is provided, immediately neutralized by a reduction in deposits and the incurrence of a loan portfolio or several loan liabilities, respectively (as mentioned in our letter dated from 8 September 2016). In this context, Eurostat assumes that the interest rates for the loans agreed - between the [redacted] and the [redacted] - are correctly adjusted in respect to the maturity of the loans and the credit risk of the [redacted], i.e. they are concluded on arms' length terms. In addition, it is presumed that the [redacted] will be able to repay the loans.

Against this background, Eurostat shares the view of the statistical authorities of Austria that the new compensation mechanism, whilst leaving the other parameter of the planned transfer of pension obligations unchanged, is in line with the relevant provisions of ESA 2010 and the Manual on Government Deficit and Debt regarding the transfer of pension obligations. The cash payment of [redacted] euro and the loan asset of [redacted] euro can be considered as an equal compensation for the assumption of the pension obligation ([redacted] euro) by the [redacted]. There is no impact on B.9 at the time of the transaction.

This preliminary view of Eurostat is based on the information provided by the Austrian authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view.

We would like to remind you that Eurostat is committed to adopting a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009 and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat intends, therefore, to publish all future official methodological advice (ex-ante and ex-post) given to Member States, on the Eurostat web site. In case you have objections concerning this specific case, we would appreciate if you let us know. In any case (regardless of whether you have objections or not), we would like to receive an answer from you on the issue no later than 30 November 2016.

Yours sincerely,

(e-Signed)

Eduardo Barredo Capelot
Director

Electronically signed on 31/10/2016 15:44 (UTC+01) in accordance with article 4.2 (Validity of electronic documents) of Commission Decision 2004/563