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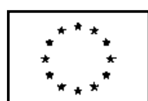
2004 EDITION

Lump sum payments to government in the context of the transfer of pension obligations



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Luxembourg: Office for Official Publications of the European Communities, 2004

ISBN 92-894-7083-6
ISSN 1725-0048

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Part II.5.3

LUMP SUM PAYMENTS TO GOVERNMENT IN THE CONTEXT OF THE TRANSFER OF PENSION OBLIGATIONS

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1. Background of the issue

1. Employers' pension schemes

In several Member States, corporations, including public corporations, may set up specific pension schemes for their own staff which they manage directly. They are referred to as "non-autonomous employers' pension schemes" in ESA 95 and these corporate pension schemes are not treated in national accounts as social security schemes, i.e. the flows of contributions (or injections of funds by employers) and pension benefits are not part of government revenue or expenditure (except if government organises a scheme for its own employees). Therefore the flows are allocated to the sector in which the employer organising the scheme is classified.[1]

In this context, employers may set up unfunded or funded schemes. The main difference is whether "segregated reserves" exist.

A non-autonomous *funded* pension scheme organised by an employer for its own staff is funded in the case where the employer builds up a segregated reserve – because of legal obligations, specific regulations, contractual clauses, accounting standards or only on a voluntary basis - for the explicit and exclusive purpose of paying pensions to their employees, ex-employees or their dependants. Consequently, the book value of this reserve as reported in the employer's balance sheet has to represent a predominant part of the actuarial value of the pension obligations.

This reserve ensures a strong protection of the pension rights of the beneficiaries, notably in the case of bankruptcy of the employer, or in the case of mergers. The reserve is invested in assets that are identifiable in the balance sheet of the corporation.

In ESA95, this obligation is recorded as AF.612 ("Net equity of households in pension funds reserves").[2]

By contrast, in a non-autonomous *unfunded* pension scheme, employers make only the commitment to ensure the payment of a defined level of pension benefits. The pension rights of the employees, that are normally legally recognised, are based in this case on the commitment made by the firm and its capacity to face the payment obligations at the time they are due.

2. Transfer of employers' pension obligations to government

Note: The case of transfer to government of a funded scheme that will remain funded after the transfer is not treated here. In this case, the rules stated in part 1 of this Manual (see 1.4) as regards the classification of funded pension schemes would strictly apply.

For various reasons, government, as owner of the public corporations, may intend to "clean" their balance sheets, for instance with a view to privatising these corporations whereas investors would be reluctant because of these obligations.

[1] See ESA95 4.88 b and c. (unfunded schemes set up by employers for their employees).

[2] Depending on the nature of the fund, the liability is valued differently in national accounts. If it is a defined-benefit funded scheme, it is the present value of the promised pension benefits. If it is a defined-contribution funded scheme (named "money purchase schemes" in ESA95), it is the market value of the corresponding assets invested on markets. For public corporations the first case is the most frequent. In the balance sheet of the corporation, generally the reserve is recorded at book value. Note that if, at a point in time, the book value of the segregated reserve is not a predominant part of the actuarial value of the pension obligations, the scheme is still considered as funded if it is obvious that the firm is acting in order to reach such a target in the medium term.

As a result of the transfer of the obligations to government, the employer's pension scheme is suppressed and the pension obligations are transferred to the government into the general social security scheme. The new scheme is unfunded (referred to as "Pay As You Go system"). In the case of a previously funded scheme, the transfer involves a change in the organisation of the pension scheme.

Note that various arrangements might be observed in the context of this transfer of pension obligations. Government could take responsibility for the payment of all the future pensions to existing employees of the corporation. It could also charge itself for only part of the future pension. Or government could pay additional amounts to pensioners in order to guarantee them a level of pensions on the basis of a current arrangement more advantageous than the new scheme they join.

The common point is that, as counterpart to the future commitments taken by government, government receives a "lump sum" that is assumed to cover the future burden of the pensions that will be paid by government.

This amount paid to government is generally an actuarial estimate of the present value of the future related government disbursements.

The assumptions underlying the method of calculation for the amount paid to government may be questionable as long-term projections of a number of variables, and their interaction, may lead to a range of estimates. However the differences generated by various assumptions are expected to remain sufficiently small to ensure that the transaction has a net present value close to zero and therefore acceptable by both parties. [3]

3. The key issue in national accounts

In general economic terms, the transaction between the public corporation and general government can be considered as a transfer of a liability in the sense of "future and certain obligations", with, as counterpart, a transfer of cash (or other financial assets). On an economic basis, the "real" net worth of both agents has not changed because of the transaction. The increase in cash of general government is compensated in economic terms by the increase in its liabilities towards the future retired employees. In parallel, the decrease in assets (cash or other financial assets) held by the public corporations is compensated by the decrease in its liabilities towards the same future retired employees. However, ESA95 does not record government obligations for unfunded pension schemes as assets of households nor as liabilities of government. This makes it difficult for national accountants to determine how to record the lump sum payments and the future payments of pensions after the transfer of responsibility from the public corporations to government as there is no specific liability in national accounts in the balance sheet of government, even when this liability was previously recorded in the balance sheet of the corporation.

This chapter explains the treatment that has been considered as the most consistent with the current national accounts framework.

[3] However in the case where government receives financial assets for a market value less than the common-approach actuarial value of the pension obligations, according to ESA95 5.136, the difference should be recorded as a capital transfer to the corporation that, therefore, would partially "offset" the capital transfer from the corporation to government.

2. Treatment in national accounts

Payments received by a government from a public corporation in the context of the transfer of obligations both under unfunded or funded pension schemes that the corporation operates for its own employees are treated as an unrequited transaction, classified as capital transfer (codified D99 in ESA95), recorded as government revenue and therefore have a positive impact on government surplus or deficit (EDPB9). The pension obligations taken over by government are not recorded in the form of an ESA95 liability.

However, this improvement in the government surplus or deficit will be offset in the future by the effective payment of pension benefits, recorded as government expenditure, to the previous beneficiaries of the scheme managed by the public corporation. Therefore, normally, the transfer of pension obligations is globally neutral for general government surplus / deficit (or very close to neutrality) over time.

As regards the time of recording, the capital transfer, and therefore the impact on government surplus or deficit, is recorded when government becomes legally responsible for the payment of the future pension benefits to the employees previously covered by their employer scheme. It is recorded for the amount agreed as payment from the corporation to government. However, the arrangement between the corporation and government might foresee a set of payments after the legal transfer and not a single payment. The part to be paid in future fiscal years would be treated as a transaction in financial instrument AF.7 (accounts receivable).

In some cases, the arrangement could foresee a transfer of pension obligations in several steps, covering each time a proportion of the employees. For each transfer, the corresponding agreed payment should be considered and any timing difference with the effective payment would be recorded as a financial transaction.

3. Rationale of the treatment

The treatment is based on the fact that ESA95, like SNA93, currently does not recognise a liability, in the sense of a financial instrument, for the obligations relating to pensions in the context of an unfunded scheme.

Under these conditions, it is not possible to consider that government incurs a liability as counterpart of the amount paid by the public corporation and representing the present value of these obligations, which should therefore be recorded as a financial transaction without an impact on government deficit/surplus. From a general point of view, the existence of new future commitments taken by government in exchange for the cash paid by the firm is not denied but the conditions in current ESA95 for the recognition of pension-related liabilities are clearly not met.[4] The payment is recorded as a capital transfer (D9) on the basis of the one-off occurrence (as evidenced by the list given in ESA95 for "other capital transfers" in § 4.165) and the high value of the transaction.

This payment could not be treated as an exceptional social contribution paid on behalf of the employees. This may be observed on an individual basis only where some employees voluntarily move from one employer to another, which involves the renunciation of a social insurance scheme and implies the transfer of past contributions to the new scheme in order to reconstitute new rights. But in the case under review, the transfer does not result from an individual decision. In addition, this would have the effect of artificially increasing the fiscal burden during the fiscal year in which the transaction takes place.

In the specific case of a funded scheme organised previously by the employer, there is no transfer of a liability to government. Actually, again because ESA95 does not recognise liabilities for future pensions in the case of an unfunded scheme[5], at the time the pension obligations are transferred to the government, the liability AF.612 disappears as the scheme is effectively transformed into an unfunded scheme, without any change in the rights acquired by the participants. Under these conditions, there is no transfer of a liability corresponding to the obligations previously borne by the corporation and the disappearance of the liability AF.6 must be recorded in the account of the corporation at the time of the transfer.

The disappearance of this liability is recorded as an “other change of volume of assets” in both accounts of households and of the corporation. Under these conditions, the pension obligations no longer take the form of a financial instrument at the time of the transfer of the scheme to the government and, therefore, the transfer of the financial assets from the corporation to the government can only be recorded as an unrequited transaction, i.e. a capital transfer improving government deficit/surplus as there is an increase in government revenue (capital transfer received).

[4] It may also be noted that some transactions recorded as transfers in national accounts may imply specific obligations for the receiver. For instance, an investment grant is generally paid only under the condition that the cash is used for acquiring certain capital goods. It is notably the case for grants from EU Structural Funds.

[5] Which is an unquestionable feature of the new pension for the corporation’s employees, unless government allocates the assets received from the corporation into a segregated reserve with the explicit and exclusive aim of ensuring the majority of the future pension benefit payments. As already stressed, government usually merges these specific obligations into the general social security obligations (or the scheme organised for civil servants in some cases) such that it becomes fully inappropriate to continue recording the specific liability of the corporation towards its employees in the national accounts.

4. Numerical examples

1. Initial unfunded pension scheme

A public corporation transfers to the government its obligations related to pensions for its staff that the corporation has organised on its own in the form of an unfunded pension scheme. Government accepts to pay future pensions and in exchange receives a cash payment of 1000. In a future given year (t+*), pensions paid to retired staff from the public corporation amount to 50.

Year t

Capital account

General government				Public corporation (NFC)			
• A		• L		• A		• L	
		D.9	+1000			D.9	-1000
B.9	+1000			B.9	-1000		

Financial account

General government				Public corporation (NFC)			
• A		• L		• A		• L	
F.2	+1000			F.2	-1000		
		B.9	+1000			B.9	-1000

Year t+* (adaptable to any year other than t)

Current/Capital account

General government				Households			
U/• A		R/ • L		U/• A		R/ • L	
D.621	50					D.621	50
B.9	-50			B.9	+50		

Financial account

General government				Households			
• A		• L		• A		• L	
F.2	-50			F.2	+50		
		B.9	-50			B.9	+50

2. Initial funded pension scheme

The conditions of the transfer are similar but the scheme was organised in the form of a funded pension scheme.

The government accounts are similar to the case of an unfunded scheme.

Accounts of the corporation are different for year t while the accounts of households are now affected.

Year t

General government				Public corporation			

Opening balance sheet

A		L		A		L	
				Assets	1000		
						AF.612	1000

Capital account

• A		• L		• A		• L	
		D.9	+1000			D.9	-1000
B.9	+1000			B.9	-1000		

Financial account

• A		• L		• A		• L	
F.2	+1000			F.2	–1000		
		B.9	+1000			B.9	-1000

Other change in volume

• A		• L		• A		• L	
						AF.612	-1000
						B.10.2.	+1000

Closing balance sheet

A		L		A		L	
F.2	1000			F.2			

Households

Opening balance sheet

A	L
AF.612 1000	

Other Change in volume

• A	• L
AF.612 -1000	B.10.2 -1000

Closing balance sheet

A	L

5. Key-words and references

Social security schemes	ESA95 4.88
Employer social insurance pension scheme	ESA95 4.88
Other capital transfers	ESA95 4.164 – 4.167
Net equity of households in pension funds reserves (F.612)	ESA95 5.110 – 5.113
Defined-benefit pension schemes	ESA95 7.59
Money purchase pension schemes	ESA95 7.59