

New methodological decision of Eurostat on deficit and debt

Securitisation operations undertaken by general government

In the context of the Excessive Deficit Procedure monitoring, and following bilateral consultations with Member States, Eurostat has observed over the years various cases of securitisation operations, which have led to uncertainties as to whether the recording in national accounts was in line with the general principles set out in the European System of Accounts (ESA 95). **Eurostat, the Statistical Office of the European Communities**, has therefore taken a decision on the recording, in national accounts, of securitisation operations undertaken by general government. This decision complements and amends the decision taken on the same issue in 2002¹. The decision is consistent with the opinion adopted by the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB).

A securitisation operation occurs when a government transfers ownership rights over financial or non-financial assets, or the right to receive specific future revenues, to another unit, named the securitisation unit, that in exchange pays the originator. In order to finance the purchase, the securitisation unit borrows on its own account by, typically, issuing bonds called asset backed securities (ABS). The securitisation unit uses income generated by the transferred asset or by the specific future flows, or by sales of the transferred assets, to service its debt. Usually the lenders will have a direct and legal claim on those assets or on those flows, in the event of the securitisation unit not paying the interest and principal due.

When the proceeds obtained from the sale of the assets are higher than the initial price paid to government, and the securitisation contract includes, in addition to the initial payment by the securitisation unit, a clause on additional future payments to government, a deferred purchase price (DPP) is said to exist and all or part of the proceeds are allocated to government.

The key issue to be determined is whether a securitisation operation gives rise to revenue for the government, thereby reducing the public deficit if there is one, or whether the proceeds should be considered as government borrowing. Eurostat has decided the following:

1. All securitisation of fiscal claims by government should be treated as government borrowing.

Eurostat has observed in recent years cases of securitisation where government has sold fiscal claims (or the right to the proceeds from their collection) related to tax arrears or social contribution arrears.

All securitisation of fiscal claims should be treated as borrowing because, conceptually, taxes can only be established and raised by government as a result of its unique taxing powers. In this context, it has been observed at a practical level that it is usually government, in the context of such securitisation operations, which retains the responsibility for collection of the securitised fiscal claims, being able therefore to influence the actual collection rate and thus the "performance" of the assets sold. This indicates that the underlying risk and rewards of collection may rest with government, and that the purchaser of the asset may not be in a position to influence its performance.

Moreover, all securitisation of fiscal claims should also be treated as borrowing due to the fact that it is appropriate that the accounting treatment of such operations should be the same and not depend on the particular compilation method used to measure tax revenue in national accounts (assessment method or time adjusted cash method, as detailed in EC Regulation 2516/2000).

2. The existence of a DPP clause or of similar arrangements should lead to the classification of the securitisation operation as government borrowing.

A deferred purchase price clause, or similar arrangement, is evidence that not all risks and rewards of the operation are transferred from government to the purchaser of the assets. This would be an indication that the purchasing unit does not have the full economic ownership of the assets acquired. The existence of the DPP clause contradicts the basic assumption that ownership of the assets by a unit means that future rewards associated with the ownership is retained by the same unit.

3. A clause in the contract referring to the possibility of substitution of assets (except for marginal cases limited in scope and deriving purely from technical and material errors) should lead to the classification of the securitisation operation as government borrowing.

The existence of such a clause typically involves an option to substitute the assets transferred to the purchaser, for instance if the assets turn out, ex-post, not to exist or to be impossible to collect. This necessarily has a bearing on the actual transfer of risks and rewards between the selling and the purchasing entities.

The replacement of the assets would often *de facto* reduce the risk of the operation for the purchaser (through, for instance, the replacement of old assets with a low market value with more recent assets with a higher market value or the replacement of assets impossible to collect with additional assets) and shift in its practical implementation the balance of risks back to government.

4. A clause of the securitisation contract stipulating ex-ante government compensation to the unit (in case of government actions which are specifically related to the unit and not to different economic units more generally) should lead to the classification of the securitisation operation as government borrowing.

The possibility of providing in the contract ex-ante compensation to the unit, in case the unit would carry losses on the operation and/or would not be able to reimburse its bondholders, means that the transfer of risks from the seller to the purchaser of assets was not complete and that therefore no true sale has occurred from the point of view of national accounts.

5. When government compensates (for instance in the form of cash, of a debt assumption, or of a direct or indirect guarantee) the unit ex-post for specific events, although compensation was not originally foreseen in the contract, a reclassification of the operation as government borrowing must occur, with an impact on the surplus/deficit of government in the year in which the compensation is decided.

By providing ex-post compensation, government recognises that it had a general interest in the unit being able to reimburse its debt. Although at the outset, the transfer of risks between the selling and purchasing unit seemed complete, *de facto*, during the course of the operation, a significant part of the risk was taken back by government. Had this been known at the moment of signature of the contract, the operation would have been classified as borrowing. Since this was not the case, and as the conditions changed during the course of the operation, the reclassification of the operation as borrowing has to take place at the moment in which the decision to compensate the unit is taken by government.

The precise rules will be shortly codified by a new chapter on the accounting treatment of securitisation operations undertaken by government and included in the ESA 95 manual on government deficit and debt. The text of the Eurostat decision (as well as further information on the decisions taken by Eurostat detailed in this press release) can be found on Eurostat's website (see Activities/Eurostat news).

Application arrangements

It is important for the effective respect of the regular deficit and debt notification obligations of Member States that clear rules are set for the implementation of these changes.

In principle, national accounts practice favours backwards correction of series, in order to maintain homogenous time series, when new concepts are designed or new rules established. It is also good statistical practice to ensure an implementation of the changes which maintains maximum comparability between EU Member States.

However, the specific context of the system of fiscal reporting and budgetary surveillance under the excessive deficit procedure and the legitimate concerns for predictability in fiscal planning makes it necessary to have a clear cut-off date for the applicability of the new rules and full grandfathering of existing operations.

Furthermore, in contrast to securitisation operations carried out before 2002, when no rules existed given their novel character, and no guidance was provided in national accounts manuals, from 2003 to 2006 Member States undertook securitisation operations on the basis of specific rules set by Eurostat in 2002. If the new rules were to be applied retroactively, the result would be that the recording of fiscal policy measures designed in good faith according to the 2002 rules would have to be reconsidered.

The rule changes are applicable to all operations concluded after 1 January 2007. All past and future flows relating to securitisation operations undertaken between 2003 and 2006 should continue to be evaluated under the 2002 framework.

1. See News Release 80/2002 of 3 July 2002, available at:
http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-03072002-BP/EN/2-03072002-BP-EN.HTML

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