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New decisions of Eurostat on deficit and debt

Securitisation operations undertaken by general government

Eurostat, the Statistical Office of the European Community in Luxembourg, has taken a number of decisions on the accounting treatment of securitisation operations undertaken by general government. The decisions are in line with the European System of Accounts (ESA 95) and consistent with the opinion taken by large majority by the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB) ¹.

The rules underlying the main decisions will be codified by a new chapter on the issue of securitisation by general government and incorporated in the ESA 95 manual on government deficit and debt before the end of this year.

Securitisation operations undertaken by general government

Securitisation arrangements through the market cover mainly the case where the owner of the assets, named the "originator", transfers the ownership to another unit, generally called a "Special Purpose Vehicle" (SPV). The SPV borrows to raise the funds needed to pay the seller, generally under the form of securities, called "Asset backed securities" (ABS) that are issued on its own account and not on behalf of the seller. On some occasions, the originator may transfer to investors flows that are not attached to an asset recorded in its balance sheet prior to the securitisation transaction.

The decisions:

1. Securitisation of future flows not attached to a pre-existing asset are always to be treated as government borrowing

When government transfers to a SPV, or to another unit, specific future receipts that are not directly attached to an asset usually recorded in its balance sheet but resulting from activity undertaken by government, the securitisation unit has no involvement in the activity at the origin of the flows specified in the contract and which are assumed to be used for repayment of its debt. This unit has no control on the generation of flows unlike the case where it has the full ownership of an asset. In national accounts, such arrangements are to be considered as government borrowing.

¹ This decision does not affect the structure of current or future securitisation transactions in the EU but only their accounting treatment for national account purposes.

- 2. The granting of guarantees by government to an SPV or to another entity implies an incomplete transfer of risk and is evidence that there was not an effective change in ownership of the assets. Therefore, in the case of a securitisation operation undertaken with an SPV, it implies the reclassification of the SPV within government sector, or the recording of an implicit loan from the SPV to government**

According to ESA95, the sale of an asset implies a complete transfer of "risks and rewards". It means that the seller no longer bears any risk on behalf of the purchaser or investors in the special vehicle created on purpose in case of securitisation. Guarantees may be given by a government unit selling one asset, such that, finally, the latter would have to compensate any "failure" related to further asset "performance" (like insufficient repayments of loans, resale at a lower price than the purchase price, etc.). Such guarantees are evidence that no true sale has occurred and that the government unit has kept the ownership of the asset in the sense of national accounts. Therefore the proceeds of a securitisation transaction should be considered in this case as government borrowing, in most cases by reclassifying the SPV within the government sector.

- 3. Whenever the securitisation contract includes, in addition to the initial payment by the SPV to the general government unit, a clause on additional future payments from the SPV, specific provisions apply. In particular, whenever the difference between initial payment and the observed market price or market-based estimated price is higher than 15%, the transaction has to be treated as government borrowing.**

In cases where a securitisation contract stipulates possible future payments to the general government unit, in addition to the initial payment, linked to future cash flows resulting from the management of the securitised assets, there is a need to assess whether a complete transfer of risk has occurred. In cases where the initial payment (sale price) is clearly lower than the observed market price or a market-based price estimated by independent experts, it is considered that the purchaser of the asset bears no real risk in this transaction and that the transaction is very close to a financial borrowing. With the support of a majority of CMFB experts, Eurostat has decided that such "discount" should not exceed 15%. This upper limit corresponds to a reasonable effective transfer of risk from the respective general government unit to the SPV and can cover cases of sales of both financial and non-financial assets. Beyond this "acceptable margin", the whole transaction has to be treated as government borrowing, with an increase in government debt and no impact on deficit/surplus.

- 4. The value of the initial transaction must be recorded as an amount of cash effectively paid by the SPV to government. Possible additional payments might have an impact on net borrowing/net lending in the case of sales of non-financial assets only at the time they occur**

ESA95 provides rules about the value of a financial transaction, and its counterpart, that are to be recorded in national accounts. It is defined as the amount of means of payment exchanged. This must be applied in the case of securitisation arrangements. Therefore, where a sale price is lower than the "reference price" (but within a limit of 15% as specified above) only the sale price has to be considered. There may be an effect either on deficit/surplus and debt in the case of a sale of non-financial assets, or only on government debt in the case of a sale of financial assets. However,

possible additional payments, of amounts that are uncertain at the inception of the securitisation arrangement, could have a further impact according to the above-mentioned cases.

All securitisation operations undertaken by government in the current and in past years, will have to be classified according to these decisions. Adjustments should normally appear in the Excessive Deficit Procedure (EDP) notification of August 2002.

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Annex: CMFB Opinion on the treatment of securitisation operations undertaken by general government

Eurostat consulted the CMFB on Friday 14 June on the above-mentioned subject. The deadline for returning the questionnaire was Wednesday 26 June 2002. Both the procedure and the content of the consultation were agreed by the CMFB Executive Body. All fifteen (15) national statistical institutes and thirteen (13) national central banks from the Member States returned the questionnaire. A total of twenty-eight (28) national institutions, from all Member States, thus participated in the consultation. The ECB also provided a response.

The result of the consultation was as follows:

- On question 1 ("*Classification of securitisation units, Special Purpose Vehicles (SPVs)*"), twenty-three (23) national institutions agreed with the rules stated in the task force draft new chapter (section 2.2) on "Securitisation operations undertaken by general government" annexed to the questionnaire. Among these national institutions, ten (10) agreed with some reservations which mainly concern the current drafting of the text. Four (4) were against the proposed treatment, and one (1) national institution abstained.
- On question 2 ("*Securitisation of future flows*"), twenty-one (21) national institutions agreed with the so-called "Option 1" annexed to the questionnaire (treatment as government borrowing). Six (6) national institutions favoured the treatment as a sale of a non-financial asset under restrictive conditions (otherwise treatment as government borrowing). One (1) national institution abstained.
- On question 3a ("*Transfer of risks, guarantees given to the SPV by government*"), twenty (20) national institutions considered that, in general, the existence of a guarantee implies an insufficient transfer of risk, as stated in the task force draft new chapter (sections 2.4.1 / 3.6) on "Securitisation operations undertaken by general government", and thus a recording of the transaction as government borrowing. Three (3) national institutions argued that another case should be added in which the existence of a guarantee does not imply an insufficient transfer of risks, and thus a recording of the transaction as sale of an asset. Three (3) national institutions proposed another treatment. One (1) national institution did not respond to this question, and one (1) abstained.
- On question 3b ("*Transfer of risks, difference between estimated market price and the selling price*") fourteen (14) national institutions considered that there is an insufficient transfer of risks to the SPV when the difference between an estimated market price and the selling price is more than 15% (as stated in the task force draft new chapter (sections 2.4.1 / 3.6)). Two (2) national institutions favoured an upper limit of 50% for this difference. Eight (8) national institutions favoured another criterion or another percentage (although one of those stated that, if thresholds for this price difference were to be considered as a classification criterion, a maximum of 15% would be preferred). Three (3) national institutions did not respond to this question, and one (1) abstained.
- On question 4 ("*Treatment of a deferred purchase price*"), nineteen (19) national institutions considered that a sale from the government to the SPV should be recorded at the amount initially paid by the SPV to the government, as stated in the task force draft new chapter (sections 2.4.4, 2.4.5 / 3.6, 3.7), while the deferred purchase price is to be recorded as proposed in the draft new chapter (sections 2.5 / 3.7). Two (2) national institutions preferred to record this sale at the estimated market price, while treating the deferred purchase price as a reimbursement of a financial advance. Four (4) national institutions favoured another treatment. Two (2) national institutions did not respond to this question, and one (1) abstained.

Accordingly, the CMFB opinions are the following:

1. *Concerning the classification of securitisation units (Special Purpose Vehicles, or SPVs), the general rules stated in the task force draft new chapter (section 2.2) on "Securitisation operations undertaken by general government" should be applied.*
2. *Securitisation of future flows (not evidenced by an asset before the securitisation arrangement takes place) should always be treated as government borrowing.*
3. *In general, the existence of a government guarantee implies an insufficient transfer of risks and in that case the transaction between the SPV and the government should be recorded as government borrowing (and not as the sale of an asset).*
4. *If the difference between an estimated market price and the selling price is more than 15%, an insufficient transfer of risks between the government and the SPV has taken place and in that case the transaction between the SPV and the government should be recorded as government borrowing (and not as the sale of an asset).*
5. *If the transaction between the government and the SPV is to be classified as the sale of an asset, it should be recorded at the amount initially paid by the SPV to government, while the deferred purchase price is to be recorded as proposed in the draft new chapter (sections 2.5 / 3.7) on "Securitisation operations undertaken by general government".*
6. *A further clarification of these five opinions in the text of the draft new chapter on "Securitisation operations undertaken by the general government" is needed before this new chapter can be incorporated in the Manual on Government Deficit and Debt. In particular, this concerns the case in which securitisation operations are carried out by units other than SPVs and the role of a deferred purchase price when classifying the transactions involved in the securitisation operation. It is recommended that this new text is discussed in a meeting of the relevant working parties before it is submitted to the CMFB for final approval.*