COMMISSION DECISION

of 24 July 1998

concerning certain specific transactions identified within the work on the protocol of the Excessive Deficit Procedure, for the application of Article 1 of Council Directive 89/130/EEC, Euratom on the harmonisation of the compilation of gross national product at market prices

(notified under document number C(1998) 2204)

(Text with EEA relevance)

(98/501/EC, Euratom)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to the Treaty establishing the European Atomic Energy Community,

Having regard to Council Directive 89/130/EEC, Euratom of 13 February 1989 on the harmonisation of the compilation of gross national product at market prices (1) and, in particular, Article 1 thereof,

Whereas the definition of gross domestic product at market prices provided for in Article 2 of Council Regulation (EC) No 3605/93 of 22 November 1993 on the application of the protocol on the Excessive Deficit Procedure (2) as annexed to the Treaty establishing the European Community refers to the definition of Article 2 of Directive 89/130/EEC, Euratom;

Whereas, for the verification of the statistical data which it has to present under the protocol on the Excessive Deficit Procedure, the Commission is informed about and must assess certain specific transactions which have an impact on GDP or GNP;

Whereas, in order to apply Articles 2 and 6 of Regulation (EC) 3605/93 on the application of the protocol on the Excessive Deficit Procedure, it is therefore necessary to clarify and to complete certain rules of the ESA second edition concerning the aforementioned specific transactions, under the framework on the definition on GNPmp provided for in Article 1 of Directive 89/130/EEC, Euratom;

Whereas the measures provided for in this Decision are in accordance with the opinion of the Committee established by Article 6 of Directive 89/130/EEC, Euratom,

HAS ADOPTED THIS DECISION:

Article 1

In order to apply Article 1 of Directive 89/130/EEC, Euratom, the specific transactions which have an impact on GDP or GNP, and which have been identified before 31 December 1997, and the accounting methods which the Member States shall apply to these transactions under ESA second edition, are listed in the Annex.

Article 2

Member States shall revise their GDP and GNP estimates for the years 1994 onwards in order to take account of the accounting methods stated in Article 1.

Article 3

This Decision is addressed to the Member States.

Done at Brussels, 24 July 1998.

For the Commission

Yves-Thibault DE SILGUY

Member of the Commission

(1) OJ L 49, 21. 2. 1989, p. 26.
(2) OJ L 332, 31. 12. 1993, p. 7.

ANNEX

I. The treatment of interest in the case of deep discounted bonds and zero coupon bonds

1. *'Conventional' bonds*

ESA 79 (paragraph 706) indicates the treatment of the difference between the issue price and the nominal value for bonds that can be qualified as 'conventional' (those for which this difference is small):

— for short term bonds, the difference between the issue price and the nominal value is to be regarded as interest recorded at the issuance of the bonds; this difference has therefore an impact on government deficit,

— for medium and long term bonds, the difference between the issue price and the nominal value is not to be regarded as interest but as holdings gains and losses; this difference has therefore no impact on government deficit.

It is then necessary to set up the following distinctions:

— distinction between short term and medium-long term: this is set out at point 2 below,

— distinction between bonds for which the difference between the issue price and the nominal value is considered as small (conventional bonds) and bonds for which this difference is large (non-conventional bonds); this is the case of bonds with a deep discount or a large premium. Point 3 below deals with bonds issued with a deep discount.

2. *The distinction between short-term and medium and long-term*

Bills and short-term bonds are those with a maturity of up to and including 12 months.

This will ensure among EU countries perfect comparability of treatment for conventional bonds issued close to the nominal value and this is consistent with ESA 79; thus for short-term bonds the recording of interest payments cannot be shifted from one year to another.

3. *Deep-discounted bonds*

Deep-discounted bonds are bonds issued below the nominal value, bearing interest at a rate below the market rate.

Deep-discounted bonds shall be defined as those whose nominal coupon is less than 50 % of the corresponding yield to maturity (calculated on the basis of the issue price).

For these deep-discounted bonds, the difference between the issue price and the nominal value is to be regarded as interest, and this interest is to be accounted for at the time of redemption of the bond. This is consistent with the decision taken over the treatment of zero-coupon bonds.

4. *Zero coupon bonds*

The difference between the issue price and redemption price of a zero coupon bond shall be treated as interest, to be recorded as interest paid at the maturity of the bond.

II. The treatment of interest in the case of index-linked bonds

In the case of 'index-linked' bonds, two distinct treatments are to be applied, depending on whether the bond is linked to a consumer price index or whether it is linked to a financial asset such as a foreign currency or gold.

In the case where the bond is linked to a consumer price index, the 'capital uplift' due to the movement of the index is to be regarded as interest. The interest should be recorded at the time of the redemption of the bond.

In the case where the bond is linked to a financial asset such as a foreign currency or gold, the 'capital uplift' should not be regarded as interest but as a 'capital gain/loss', as in the case for bonds issued in foreign currency.

III. Capitalised interest on deposits and other financial instruments covered by ESA 79

The interest shall be recorded separately from the principal and the capitalised amount shall be recorded when it falls due for payment, rather than distributed between different periods. This means that, in the case of deposits or similar financial instruments which are liabilities of an institutional unit, the capitalised interest will be recorded as an expenditure of this institutional unit when the interest is paid to the holders of these instruments.

IV. Treatment of fungible bonds issued in several tranches ('coupons courus')

In the case of fungible bonds (bonds which are issued in tranches at different points in time without change in the date of payment of the coupons) the accrued coupon shall be recorded as a short term liability under the heading 'Accounts receivable and payable' (code F72 of ESA 79).

In practice this means that, if an institutional unit issues a bond in different tranches but with the same coupon, it will raise the issue price of the more recent tranches to provide the same yield to all holders of the bond. The difference between the original issue price and the higher issue price of the second tranche is recorded as a short term liability to the holder of the second tranche, which will be reimbursed when the coupon falls due.

V. Linear bonds

Linear bonds are, like fungible bonds, bonds issued in several tranches from the same lineage, i.e. with the same nominal interest rate as well as identical dates for the payment of coupons and for reimbursement at maturity.

They are characterised by the fact that new tranches can be issued several years after the first issuance. They are therefore issued with discounts and premia which can be significant as a result of changes in market interest rates in the intervening period since the first issuance.

In order to differentiate between the nominal value and the price at issue (discount or premium) at the time the new tranche is issued, a distinction must be made between tranches issued within twelve months of the first emission, and tranches issued beyond twelve months.

For each tranche issued in the twelve months after the first issue, the difference between the nominal value and the issue price (discount or premium) must be treated as a capital gain or loss.

For each tranche issued beyond the twelve months following the first issue, the difference between nominal value and issue price (discount or premium) must be treated as interest.

VI. Financial leasing

All leasing transactions have to be treated as operating leasing. For example, this means that if an institutional unit sells real estate or other fixed asset and rents it back with the intention of acquiring it at the end of the lease (this operation therefore having many characteristics of a financial lease), the transactions must be treated as an operating lease. Therefore the receipts from the sale of the real estate are recorded as a receipt reducing the deficit. The obligation to buy back the assets at the end of the lease is a contingent liability which is not recorded in debt.

VII. Classification of national bodies acting on behalf of the EC (EAGGF etc.)

Those institutional units which perform market regulation activity and distribute subsidies must be classified as follows: if these institutional bodies cannot be split into those which do the market regulation and those which do the distribution of subsidies then these units should be classified in the sector general government if their costs incurred in market regulation compared to the total costs are less than 80 %.

VIII. Swaps on interest rates and currency swaps

In the case of interest rate swaps, only the net payments (receipts) of interest between the two parties to the swap should be recorded.

In the case of currency swaps, any outstanding foreign currency debt should be valued according to the market exchange rate and not at the exchange rate agreed in the swap contract.

IX. **Pension funds**

Certain pension funds which finance benefits mostly on a pay-as-go basis and to a minor extent on a capital funding basis have to be classified in the subsector social security funds of general government.

The classification criteria are that these funds are institutional units, as they have a complete set of accounts and autonomy of decision, and that they pay benefits to the insured without reference to the individual exposure of risk, which means that these employment based pension schemes are built on a collective financial balance principle.