

The classification and terminology of financial corporations in the updated SNA (issue C30, also related to units (issue 25))

The ECB's comments on this issue are twofold:

1. They refer to the concerns expressed by the ESCB's Statistics Committee and already communicated to the ISWGNA related to the recommendation of the AEG to classify *money market or cash funds* (MMFs) with other types of investment funds, whether in S.123 or in a new investment fund sub-sector. Accordingly, *a revised sub-sectorisation of financial corporations* is considered.
2. There is still no clear insight in the treatment of institutional units which are supposed to belong to the financial corporations sector but provide neither financial intermediation nor financial auxiliary services. In this context, the treatment of *holding corporations* and *other SPEs* needs further attention.

2.1 Money market funds (MMFs)

While MMFs obviously have some features in common with bond, equity, real estate, etc. funds, the monetary nature of their liabilities implies that their economic character is significantly different. This should then also be reflected in their classification. After all, the main reason for distinguishing between S.122 and S.123 institutional units is that the former have monetary liabilities while the latter do not. A corresponding proposal was submitted to the ISWGNA for further consideration.

This proposal gives priority to maintain consistency between money and banking statistics and financial accounts. It also implies that the definition of "the banking sector for monetary policy purposes" varies somewhat depending on the monetary aggregates in operation, and this flexibility needs to be reflected in the SNA.

2.2 Financial corporations by sub-sector

Section D of the 1993 SNA Chapter IV on institutional units and sectors specifies the financial corporations sector and its sub-sectors – the central bank, other depository corporations, other financial intermediaries except insurance corporations and pension funds, financial auxiliaries, and insurance corporations and pension funds. The 1995 ESA has taken up almost the same sub-sectorisation with one main exception, the sub-sector monetary financial institutions (MFIs) for statistical purposes as defined by the ECB, in order to guarantee consistency between the ECB money and banking statistics and the ESA financial accounts as well as other national accounts (such as interest payable and receivable).

A possible approach would be to link the type of the financial corporation with the predominant type of financial assets/liabilities it deals with. The *first grouping* consists of institutions incurring liabilities mainly as components of broad money. These components might be currency and deposits as well as other liquid instruments like money market funds or short-term debt securities issued by these institutions. Such institutions should be classified as monetary financial institutions (the central bank and the commercial monetary financial intermediaries including MMFs).

A second grouping refers to investment funds (without MMFs, if they are included into the first grouping) acquiring various types of financial or non-financial assets, while *a third grouping* covers insurance corporations and pension funds, which mainly incur insurance technical provisions and invest in different types of financial assets like debt securities, equity and investment fund shares. *A fourth grouping* comprises miscellaneous financial intermediaries such as securitisation vehicles, parent corporations providing financial services, security and derivative dealers, and financial corporations engaged in lending. These types of financial institutions might have to be specified, described in some detail, and defined as this has already been done in the context of the ESCB's other financial intermediaries except insurance corporations and pension funds (OFI statistics).

The four groupings mentioned above are the institutions that predominantly provide financial intermediation services. The *fifth grouping* covers all financial auxiliaries. Financial intermediaries and financial auxiliaries might have to be distinguished from other institutional units providing neither financial intermediation nor financial auxiliary services, like brass plates, empty shells or (specific)

holding corporations. These entities are treated as institutional units if they are resident in an economy different to their parent company. They may have to be reclassified as ancillary units when compiling currency union accounts, if the parent companies are resident in other countries of the currency union.

2.3 Holding corporations

Holding corporations, if they are not financial intermediaries, belong to this type of other financial institutions. Their description must still be refined in the new SNA because there is some confusion whether the type of activity of the holding itself (paragraph 4.37) or the preponderant type of activity of the group controlled by the holding (paragraph 4.100) determines the sector or sub-sector of the holding.

The paragraphs 4.36 and 4.37 of the 1993 SNA distinguish two types of parent companies [corporations]: (a) companies with a significant production of their own which acquire control over other corporations to strengthen their own position as producers; and (b) companies controlling and directing a group of subsidiaries without having significant production of its own holding corporations. The activities of both types of companies are deemed to be distinct from the activities of the units which they control.

Following this line of reasoning, a parent company of type (a) would be classified according to its main activity, which might be the production of market goods and non-financial services or the production of financial services, but not the control of the group. Accordingly, such a corporation would be classified either as a non-financial corporation or as a financial corporation. The classification of the parent company of type (b) has to be carried out by convention. According to the new ISIC (ISIC rev 4), these parent companies corporations are subsumed under the ISIC class 6420 (financial and insurance activities) describing their activities as "units that hold the assets (owning controlling-levels of equity) of a group of subsidiary corporations and whose principal activity is owning the group. The holding companies in this class do not provide any other service to the businesses in which the equity is held, i.e. they do not administer or manage other units".

The AEG recommendation on holding corporations (parent companies of type (b)) is consistent with the new ISIC by classifying them as miscellaneous financial institutions. Otherwise, to classify parent companies of type (a) always as non-financial corporations seems to be too narrow. It would be preferable to classify parent companies of companies carrying out (mainly) non-financial activities as non-financial corporations, but also to classify parent companies of companies carrying out (mainly) financial activities as financial corporations.

A more consistent approach would be to distinguish between

- (i) Parent corporations, actively managing their group (covering non-financial corporations carrying out mainly non-financial activities and financial corporations carrying out mainly financial activities);
and
- (ii) Holding corporations (owning a group) without any financial or non-financial activities, if these are identified as separate institutional units.

The classification of these two types of corporations would be as follows: While parent corporations would be either part of the non-financial corporations sector or of the financial corporations sector, holding corporations would be, by convention, specified as *other financial institutions*.

2.4 Proposal for classification of financial corporations by sub-sector

Following the discussion above the following breakdown of the financial corporations sector into sub-sectors is suggested. According to the first grouping as described above, all monetary financial institutions could be classified in one sub-sector. There are also good reasons to show separately the *central bank* and the *commercial monetary financial institutions including money market funds* (as issuers of broad money) in two separate sub-sub-sectors.

Insurance is subdivided into life insurance and non-life insurance. Life insurance is provided by insurance corporations and pension funds. While we would like to analyse life insurance separately, this may be difficult to ensure via appropriate sub-sectoring as the institutional units insurance corporations cannot be broken down into a life and a non-life services part. Accordingly, *insurance corporations and pension funds* are classified in a second financial corporation sub-sector, with a further optional breakdown into the two components.

The remaining financial corporations are rather heterogeneous; in the current SNA/ESA, they are subdivided into the two sub-sectors ‘other financial intermediaries’ (S.123) and ‘financial auxiliaries’ (S.124). For the new SNA, it is recommended to include all institutions in one sub-sector *miscellaneous financial corporations*. It covers the investment funds (without MMFs, if included in the first sub-sector), various types of financial intermediaries such as securitisation vehicles, parent corporations providing financial services, security and derivative dealers, and financial corporations engaged in lending, as well as financial auxiliaries and (by convention) some institutions such as holding corporations, brass plates or empty shells. It is necessary to describe in detail the content of this sub-sector as it would allow, in addition to the separation of *investment funds*, a further breakdown of the *other financial institutions* if needed in future. This specifically refers to the various types of financial intermediaries as they collect funds from lenders and transform, or repackage, them in terms of maturity, scale, risk or the like, in ways which suit the requirements of borrowers. In addition, these financial intermediaries place themselves at risk by this transformation activity. Special attention also needs the description of the institutions such as holding corporations providing no goods or services and performing no financial intermediation. They are usually created to obtain tax or regulatory advantages.

Table 1 : Proposed classification of financial corporations sector by sub-sector *)

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| <p>Financial corporations (S.12)</p> <p>1. Monetary financial institutions (S.121)</p> <ul style="list-style-type: none"> ▪ Central bank (S.1211) ▪ Commercial monetary financial institutions (including money market funds (S.1212)) <p>2. Miscellaneous financial corporation (S.122)</p> <ul style="list-style-type: none"> ▪ Investment funds (without money market funds) (S.1221) ▪ Other financial institutions (intermediaries, auxiliaries, and other institutions) (S.1222) <p>3. Insurance corporations and pension funds (S.123)</p> <ul style="list-style-type: none"> ▪ Insurance corporations (S.1231) ▪ Pension funds (S.1232) |
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*) The sector codes used in the table are different to those applied in the 1993 SNA.

The proposal as outlined above and illustrated in Table 1 has the advantage to clearly specify the main groupings of financial intermediaries covered by the three sub-sectors. It would also allow compiling from-whom-to-whom financial accounts and balance sheets based on available monetary and financial data, while not much data are available for the still rather small *miscellaneous financial corporations* sub-sector, except for investment funds.