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9th Meeting of the Advisory Expert Group on National Accounts,
8-10 September 2014, Washington DC

Agenda item: 5.2

Institutional sub-sectors and the delineation of head offices, holding companies and special purpose entities

Introduction

The outcome of the consultation of the AEG at its last meeting on the classification of head offices, holding companies and SPEs is presented in this session. Countries reported that they experience difficulties when implementing the 2008 SNA recommendations on the delineation of the more detailed sub-sectors within the financial corporations sector (and the provision of information related to them), and the classification of head offices, holding companies and SPEs.

Documentation

A proposed note for the SNA News and Notes

Main issues to be discussed

- Does the note reflect the recommendations of the AEG at its 8th meeting?

Implementing the distinction between Head Offices and Holding Companies in National Accounts

1. Introduction

1. The 2008 SNA contains a more explicit definition of financial services than the 1993 SNA, amongst others to ensure that the change in financial services other than financial intermediation is appropriately captured. The 2008 SNA has also introduced a more detailed classification of the financial corporations' sector, to allow for more flexibility and an improved consistency with other monetary and financial statistics such as those of the International Monetary Fund (IMF) and the European Central Bank (ECB).

2. A new feature of the 2008 SNA (paragraph 4.53 - 4.54) is the explicit recognition of (the distinction between) head offices and holding companies:

- A holding company (HC) is described as a unit that holds the assets of subsidiary corporations but does not undertake any management activities.
- The activities of a head office (HO) include the overseeing and managing of other units of the enterprise and managing the day-to-day operations of their related units.

3. The distinction between HOs and HCs directly affects the compilation and analysis of the institutional sectors within an economy. According to the new standards HCs are to be classified in the financial corporations' sector, while head offices are allocated to the non-financial corporations sector, unless all or most of their subsidiaries are financial corporations. The 1993 SNA did not give any explicit guidance on the treatment of head offices, the whole group of 'holding corporations' being defined as corporations owning and directing a group of subsidiaries, and to be classified according to the main activities of their subsidiaries.

4. The delineation and classification of HOs and HCs, usually holders of significant assets (and liabilities) and thus important receivers and payers of property income, may have a significant impact on the allocation of primary income in the non-financial sector accounts. As a consequence, it was considered relevant to develop more specific recommendations to arrive at an internationally comparable treatment of these units. This work has been done under the umbrella of the Inter Secretariat Working Group on National Accounts (ISWGNA). A Task Force, initiated and prepared by the ECB, Eurostat and the OECD, met in 2013 in Frankfurt am Main. The Task Force submitted their results to the Advisory Expert Group on National Accounts (AEG), for consideration at their meeting of 29-31 May 2013 in Luxembourg. The conclusions presented in this note take into account the AEG views. The final Task Force report is available following this link:

http://epp.eurostat.ec.europa.eu/portal/page/portal/esa_2010/documents/Final_Report_Task_Force_SPEs.pdf

5. In addition, the Task Force provided some more guidance on the treatment of special purpose entities (SPEs). This work is still ongoing. In particular, the treatment of intellectual property products (IPPs) is being further elaborated by the UNECE Task Force on Global Production and will be described in a later edition of SNA News and Notes.

2. The issue of institutional independence

6. The international standards contain references to certain entities that do not qualify as institutional units. The 2008 SNA describes such entities that cannot act independently from its parents as “passive holders” and “artificial subsidiaries”. Such an entity is not treated as a separate institutional unit unless it is resident in an economy different from that of its parent. At the same time, one of the changes to the international standards was the widening of the financial corporation sector by the new sub-sector 'captive financial institutions and money lenders'. Holding companies only holding assets (controlling levels of equity) are declared as an example of captive financial institutions (SNA 2008, paragraph 4.114 b). Therefore, it was considered necessary to particularly elaborate on the criteria for the institutional independence of HCs that are themselves subsidiaries of (resident) corporations. In this respect, the following principles have been agreed upon:

- The standard criteria for an institutional unit should always be applied – thus also for HOs and HCs.
- Entities owned by non-residents are always to be considered as institutional units.
- For entities wholly owned by a single resident unit, 'no employees and no compensation of employees' is a not a sufficient criterion for lack of institutional independence; however it can be used as an indicator to consider units for further investigation on its lack of independence.
- Having multiple parents/shareholders is a sufficient qualification for a unit being an institutional unit.
- Head offices are always to be considered as separate institutional units.

3. The identification of Head Offices and Holding Companies

7. The statistical analysis of HOs and HCs and their delineation starts after the examination of their institutional independence, as described in the above. Both types of units are often referred to as holding companies, because both of them have relations to other entities, their subsidiaries. Starting from this characteristic, information on the structure of the balance sheet is one potential identifier of whether one deals with a head office or a holding company. It was agreed that thresholds of - at least - 50% for the share of equity vis-à-vis subsidiaries within the balance sheet total would be an appropriate criterion for distinguishing HOs and HCs from other institutional units, as follows:

- An entity having at least 50% of its assets consisting of equity vis-à-vis its subsidiaries can be considered as a practical indicator for the identification of such entities.

Although currently balance sheet data is not always available in (business) registers, it is strongly recommended to make efforts towards making available this kind of information. The (future) availability of balance sheet data in business registers would most certainly facilitate and economise an appropriate rules based identification of HOs and HCs in register data or similar data sources. Balance sheet data are generally available in the context of central balance sheet offices, tax authorities' fiscal databases, and specialized surveys. The incorporation of this kind of information into business registers, amongst others to ensure the correct identification of HOs and HCs, is an important task, requiring intense collaboration of the institutions engaged.

8. Where balance sheet data is not available other supporting information has to be analysed. The information on the relation to an enterprise group (control and ultimate parent, affiliates) in conjunction with small turnover may be one possibility for identifying HOs and HCs.

4. The distinction between Head Offices and Holding Companies

9. From a conceptual point of view the distinction between HOs and HCs is clear. However, applying the concepts in practice is more complicated. The statistical identification of these units, as either a HO or a HC, is often based on a self-classification by the unit, or an assessment and/or guided registration by national statistical authorities. This pure labelling of an entity as “holding company” or "managing fund" may often be misleading. Therefore, feedback loops from a central information point to the corporation and other data providers are necessary in order to achieve a consistent treatment of entities in the various registers. In addition, it is important to follow the 2012 AEG recommendation that a strict definition of holding corporations, in the sense that holding corporations do not provide any management services, should be applied when classifying institutional units as holding corporations.

10. The international discussion on rules for distinguishing between HOs and HCs showed that information on variables like management control or auxiliary units are available for large units or large groups only. Wherever available, such data is quite relevant in view of the large proportion of the aggregate balance sheet that can be explained by these units.

11. For units where such information is not available, or only available at great cost in practice, it was agreed that the distinction between HOs and HCs should be based on the employment criterion, as follows:

- HOs are actively engaged in production. They may have noticeably fewer employees, and more at a senior level, than its subsidiaries. But having zero employment is a clear indication of not being a HO.
- On the other hand, HCs simply holding assets may do this with very few or without any employed personnel. In this respect, it should be noted that the Task Force agreed that a HC without employees will not pass the institutional unit test when it is fully owned by a single resident unit.

12. A one dimensional application of the employment criterion, classifying all units with employment as head offices, will not lead to high quality results. Requirements set out by national legislation in relation to the institutional set-up of such units may result in some employment recorded in registers. Therefore, it was agreed that the following practical rule should be applied:

- Employment thresholds for the delineation between HOs and HCs should be determined taking into account national circumstances. In particular, national legislative requirements for the number of employees of HCs should be taken into account. As a general indication, employment of three or more persons, or employment exceeding the national legal minimum employment, is a first indicator for a unit being a HO.

13. Other criteria may refine the delineation process. This may include the analysis of sales. Does the entity have substantial sales of goods and services? As HCs usually don’t have turnover this may be an indicator for a unit being a HO. Also additional information regarding the employment may be considered: does the employment structure reflect the status of the entity? For example, the employment of very senior staff may be a signal that one is dealing with a HO.

14. Finally, it should be noted that the application of these practical criteria won’t cover 100% of all cases. Some HOs or HCs may show different characteristics and therefore need an individual analysis. In this respect, costs and benefits should be appropriately balanced and transparency should be enhanced by the provision of adequate metadata.