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ISSUE NOTE: Action point A.6: Treatment of trusts and other types of funds as separate institutional units

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The issue of the treatment of trusts is part of the SNA Research Agenda; see paragraphs A4.14 and A4.15 of the 2008 SNA, where the following is stated: "The SNA recommends that trusts be treated as quasi-corporations. In some cases, though, when one is used in effect as an SPE for a corporation, it is not considered to be a separate institutional unit but is merged with its parent, so long as they are both resident in the same economy. No detailed description of trusts is given, though some may be owned by households and NPIs as well as by corporations. Further clarification on the nature of trusts and when their assets should be treated as belonging to separate units and when merged with the assets of their owners would be helpful".

This issues note provides recommendations on the definition and treatment of trusts. In doing so, the topic has been broadened to the treatment of funds, in which assets are accumulated and several agents managing and/or administrating and benefiting from these funds are involved, more generally. The latter primarily relates to investment funds and pension schemes.

Section I: The issue

1 Although trusts have been touched upon in Guidance Note F.1 on More disaggregated institutional sector and financial instrument breakdowns as well as Guidance Note F.6 on Capturing non-bank financial intermediation in the System of National Accounts and the External Sector Statistics, the issue of how to define trusts, including when, and when not, to treat trusts as separate institutional units, is currently not covered explicitly in the 2008 SNA.[1] The issue of whether or not an entity should be considered as a separate institutional unit has also popped up in the discussions on investment funds (see Guidance Note D.16 on Treatment of retained earnings) and pension schemes. Having more specific guidance on the treatment of such funds is considered very useful. To move forward, it has been proposed and agreed that a small team of experts collects available guidance, and draft a short issues note with some more concrete guiding principles for determining when trusts and other types of funds should be considered as separate institutional units, or be consolidated with other units, such as their owners/beneficiaries.

2 This issues note first discusses, in Section II, the current guidance on the treatment of trusts and similar investment-type of funds in the 2008 SNA as well as the current guidance on pension schemes. Subsequently, Section III provides a decision tree for the

[1] It should be noted that they are addressed in the ISIC Rev.4 in terms of the industrial classification.

treatment, including its classification in institutional sectors and sub-sectors, of trusts and similar types of funds. The latter does not include the treatment of pension schemes, which are somewhat different from trusts and investment funds in respect of the economic agents involved. Sections IV and V then narrow the discussion down to trusts (which also includes guidance on the delineation of this group of units), and investment funds. Section VI contains a further elaboration, including decision trees, for the treatment of pension schemes. Section VII concludes with a summary of the recommendations for changing and/or clarifying the current guidance provided in the 2008 SNA and BPM6, for consideration by the Advisory Expert Group (AEG) on National Accounts and the IMF Balance of Payments Committee (BOPCOM).

Section II: Treatment of trusts, investment funds and pension schemes in current international standards

3 For a discussion on whether or not a unit can be considered as a separate institutional unit, the definition of an institutional unit is of course highly relevant. Paragraph 4.2 of the 2008 SNA provides this definition, as follows: "*An institutional unit is an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities. The main attributes of institutional units may be described as follows:*

a. An institutional unit is entitled to own goods or assets in its own right; it is therefore able to exchange the ownership of goods or assets in transactions with other institutional units;
b. It is able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law;
c. It is able to incur liabilities on its own behalf, to take on other obligations or future commitments and to enter into contracts; and
d. Either a complete set of accounts, including a balance sheet of assets and liabilities, exists for the unit, or it would be possible and meaningful, from an economic viewpoint, to compile a complete set of accounts if they were to be required".

4 Looking at trusts and similar types of funds more specifically, it can be noted that paragraph 4.48 of BPM6 contains a general definition of trusts, while other paragraphs include various generic references to trusts. On the other hand, the 2008 SNA lacks such a definition, and includes a number of references, sometimes containing conflicting messages. In paragraph 4.43 of the 2008 SNA, it is noted that quasi-corporations may refer to, amongst others "*unincorporated enterprises, including unincorporated partnerships or trusts, owned by households that are operated as if they were privately owned corporations*".

5 In relation to family trusts owned by households, paragraph 24.75 of the 2008 SNA includes the following guidance, basically suggesting that these trusts should always be treated as institutional units: "*Trusts may be set up to protect wealth until a beneficiary comes of age or meets another criterion, they may be set up to preserve family estates and so on. The SNA recommends that trusts should be treated as quasi-corporations and included in the financial corporations sector as captive financial institutions*". Moreover, paragraph 4.114, defining the sub-sector captive financial institutions and money lenders,

contains an explicit reference to trusts: "units which are legal entities such as trusts, estates, agencies accounts or brass plate companies".

6 On the other hand however, the 2008 SNA is much more restrictive when it comes to trusts set up by corporations for similar reasons to subsidiary corporations (see paragraph 4.63 and 4.64 of the 2008 SNA for a description of subsidiary corporations). In paragraph 4.65 of the 2008 SNA, it is stated that "*these are also treated as an integral part of the parent and their accounts are consolidated with the parent*".

7 Moreover, in describing captive financial institutions, which includes "*units with the characteristics of SPEs … including investment and pension funds and units used for holding and managing wealth for individuals or families*". Whether or not these units are to be considered as separate institutional units is then further described in paragraphs 4.60 and 4.61 of the 2008 SNA, where the former paragraph states the following: "*The degree of independence from its parent may be demonstrated by exercising some substantive control over its assets and liabilities to the extent of carrying the risks and reaping the rewards associated with the assets and liabilities. Such units are classified in the financial corporations sector*". The latter paragraph notes that "*An entity of this type that cannot act independently of its parent and is simply a passive holder of assets and liabilities (sometimes described as being on auto-pilot*[2]*) is not treated as a separate institutional unit unless it is resident in an economy different from that of its parent*". Apart from still leaving quite some room for interpretation whether or not a unit can be treated as an institutional unit, this guidance looks somewhat conflicting with the guidance on family trusts owned by households in paragraph 24.75 of the 2008 SNA, unless one would assume that trusts are never to be considered as being on autopilot, or always exercise some substantive control over their assets and liabilities to the extent of carrying the risks and reaping the rewards associated with the assets and liabilities.

8 More generally, paragraph 26.41 of the 2008 SNA contains guidance on the residence of units, among which trusts holding private wealth. In cases where the physical location of an enterprise is not sufficient to identify its residence because the enterprise has little or no physical presence, because for example its administration is entirely contracted out to other entities*, "its residence is determined according to the economic territory under whose laws the enterprise is incorporated or registered".*

9 Importantly, the current guidance of the 2008 SNA on trusts is quite divergent from the guidance provided in the Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG), in which paragraph 3.184 states the following: "*Personal trusts control portfolios of assets owned by individuals, and assets within personal trusts are treated as part of the direct holdings of the households that control the trust. … In general, trusts are not recognized as separate institutional units and are consolidated within the units that control or benefit from them. Only in two circumstances are trusts treated as separate institutional units, that is, as quasi-corporations: (1) if they are constituted in a different*

[2] Being on autopilot has not been defined in the 2008 SNA. One may assume, however, that in this context it means that the accumulated assets are simply allocated to a trust which does not have any significant element of operational control about the investments.

economy to that of any of the beneficiaries; or (2) otherwise satisfy the definition of a quasi-corporation". In relation to the latter exception, a quite restrictive interpretation is provided, as follows: "*For instance, trusts established for some types of financial intermediation (e.g., securitization, collateralized security issuance, investment pooling) may be recognized as separate units if (1) they act like financial intermediaries, and (2) no other unit can reasonably be considered as controlling the portfolio".*

10 Furthermore, when providing guidance on the equity and investment shares, paragraph 11.96 also contains a reference to trusts, as follows: "*Investment funds include mutual funds and unit trusts. Investment funds issue shares when a corporate structure is used and units when a trust structure is used. Investment fund shares refer to the shares issued by mutual funds, rather than the shares the mutual fund may hold"*. Although reference is made to trusts, this typically refers to a slightly different type of arrangements. A unit trust is a type of mutual fund, often not having a separate legal entity, where money from many investors (called "unit holders") is managed by a fund manager. On the other hand, investment trusts typically refer to limited companies whose business is the investment of shareholders' funds, the shares being traded like those of any other public company.

11 More specifically related to the treatment of investment funds as separate institutional units, the 2008 SNA does not provide any specific guidance, for example on whether or not to separate the funds from its managers/administrators. The same is true for the Manual on Financial Production, Flows and Stocks in the System of National Accounts (MFPFS). However, both the 2008 SNA and MFPFS provide a listing of financial auxiliaries, thereby also including "*managers of pension funds, mutual funds, etc. (but not the funds they manage)"*[3], which one could interpret as suggesting that the relevant funds and the managers of these funds need to be separated.

12 When it comes to pension schemes, paragraph 17.131 of the 2008 SNA is quite relevant. After stating that for both defined contribution schemes and defined benefit schemes a pension fund is assumed to exist, it says the following: "*For a defined contribution pension scheme, a fund must exist. For a defined benefit pension scheme a fund may exist in reality or it may be a notional fund. If it exists, it may be part of the same institutional unit as the employer, it may be a separate institutional unit (an autonomous pension scheme) or it may be part of another financial institution, either an insurance corporation or a multiemployer pension scheme*". No further guidance is provided on the question of which pension schemes are to be treated as separate institutional units, apart from a short reference in paragraph 8.78 of the 2008 SNA describing other employment-related social insurance schemes.

13 This paragraph 17.131 of the 2008 SNA has generated quite some confusion. First of all, one could implicitly derive from it that a defined contribution scheme is always to be

[3] Please note that in the 2008 SNA the term "manager" is used in two ways. In the case of investment fund manager, it usually refers to the one who takes care of the investment of the accumulated funds, including the back office administration. In the case of pension schemes, the pension manager refers to the one who is responsible for any shortfall of accumulated assets as compared to the pension entitlements. See paragraphs 14, 28 and 48 – 50 for more details on the economic agents involved.

regarded as a separate institutional unit. Furthermore, it does not provide any guidance on the treatment of defined benefit schemes, i.e., under which conditions such pension schemes are to be treated as separate institutional units.

Section III: Criteria for the institutional unit test of trusts and similar type of funds

14 When looking at trusts and similar type of funds, thus excluding for the time being pension schemes which will be discussed in Section VI, it is important to distinguish between the various actors potentially involved : (i) the fund itself, (ii) the beneficiary, or beneficiaries, of the proceeds derived from the accumulated assets, and (iii) the manager of the funds, who primarily takes care of the administration, including the investment decisions of the funds (although in some cases, managing investments and fund administration might be separated in different institutional units), and who may or may not be the one running the risks and receiving (some of) the rewards.[4]

15 All issues concerning the institutional unit test and the classification of units relate to situations where an investor, here used as being equivalent to the beneficiary, is hiring professional services to manage the investments. So, at least two entities of the kind listed above are involved: the investor and the firm providing management and administration services (the fund manager). In some cases, it is needed to consider a third unit, the fund or the trust, which may not meet all criteria for being treated as a separate institutional unit but is still needed to adequately portray the distribution of risks and rewards. In fact, the distribution of risks and rewards across the economic agents involved may be the single most important criterion for the allocation of assets and liabilities to institutional units.

16 Looking at the various arrangements, the decision tree on the following page is recommended for the institutional unit test. First, the question needs to be answered who is exposed to the risks and rewards of the assets in which the funds are placed: the fund manager or the investor(s)? If the fund manager bears the risks and receives the rewards, then that unit is to be considered as a financial intermediary, not a mere asset manager anymore, and the assets in the fund should be consolidated within the accounts of that unit, which is to be classified in either sub-sector S.122 Deposit-taking corporations, except the central bank[5] or S.125 Other financial intermediaries, except insurance corporations and pension funds.

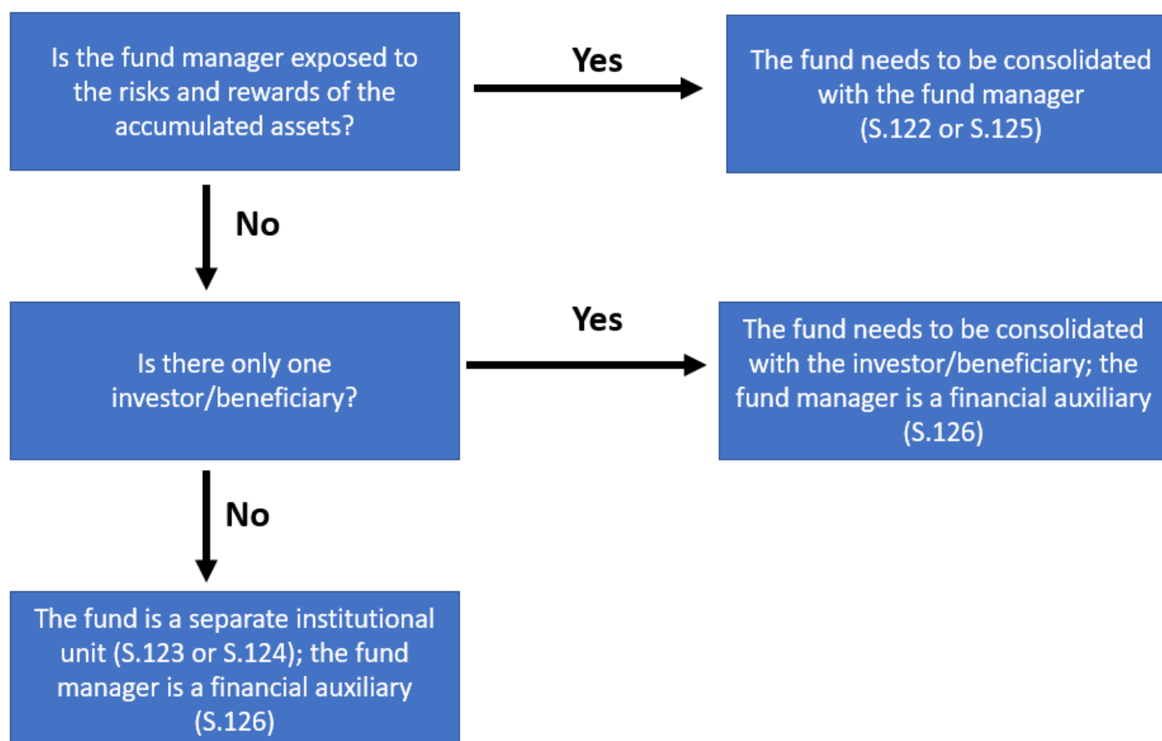
17 On the other hand, if the investor(s) bear the risks, then the question arises whether there is a single investor or several investors. In the case the investor is a single economic agent, then the assets should be consolidated in the accounts of the investor, even if a separate legal unit is created to hold the assets, unless this unit is created in a country different from the investor, in which case the relevant (notional) unit is to be classified as

[4] This does not preclude that in some cases the fund may have its own staff, and thus (partially) taking care of the administration herself. However, in these cases the institutional unit test would not pose any significant problems.

[5] This classification would only be the case, if the deposit-taking corporation perform the role of fund manager as a secondary activity.

part of S.127 Captive financial institutions and moneylenders.[6] Furthermore, the investor is considered to consume asset management and administration services provided by the manager, to be classified in S.126 Financial auxiliaries.[7] However, if there are multiple investors, then the fund should be treated as a separate institutional unit, to be classified as part of S.123 Money market funds, or S.124 Non-MMF investment funds. Here too, the fund manager is to be treated as a financial auxiliary providing asset management and administration services to the investors, and thus to be classified in sub-sector S.126.

18 In its simplest form, the decision tree could then be portrayed as follows:



19 In this decision tree, it is assumed that for the entities which are to be treated as separate institutional units, a complete set of accounts, including a balance sheet of assets and liabilities, exists for the entity in question, or that it is possible and meaningful, from an economic viewpoint, to compile a complete set of accounts, in line with the criteria for an institutional unit, as listed in paragraph 4.2 of the 2008 SNA. Autonomy of decision, another criterion for an institutional unit, can sometimes be more problematic. For this type of funds, it is usually the one managing the fund who is taking the decisions on behalf of the unit involved. It is proposed here to somewhat alleviate this requirement of autonomy of

[6] There may be exceptions to this rule. One may have, for example, large family trusts which operate like a corporation, and as such could be regarded as a quasi-corporation, similar to large unincorporated family enterprises. These and other details will be discussed in Section IV.

[7] Obviously, the asset management services could also be provided, as a secondary activity, by another financial corporation such as a bank.

decision[8]. Otherwise, one would end up with consolidating the relevant funds with the fund manager. In some cases, however, it may not be feasible to disentangle the fund manager from the fund itself, as a consequence of which the whole entity would end up in the investment funds' sub-sectors.[9]

20 With these criteria and related decision tree, the following two sections will look in more detail at trusts and investment funds. Where relevant, specific cases will be addressed.

Section IV: The treatment of trusts

21 Before discussing the treatment of trusts in more detail, it is good to arrive at a better understanding of what exactly constitutes trusts.[10] This is also mentioned explicitly in the SNA Research Agenda as an item where further clarification would be welcome. More generally, trusts can be defined as arrangements whereby an economic agent (a trustee) holds property (but not economic ownership) as its nominal owner for the good of one or more beneficiaries. Their job is to hold, manage and administer the funds in the trust on behalf of the settlor (the creator of the trust). Their fiduciary duty as a trustee requires them to act in the best interest of the beneficiaries of the trust. The duties of a trustee are laid out upon the creation of the trust, and while they may differ depending on the situation, some tasks are common. The trustee oversees the distribution of the trust's funds to the beneficiaries. While the assets remain a part of the trust, the trustee is responsible for any investments that are made, ensuring any assets included in the trust, taking care of the administration, and overseeing the payment of taxes.

22 Several kinds of trustees, and accordingly trusts, can be distinguished:

- charitable trustees manage funds left in a charitable trust and follow the instructions left by the creator of the trust;
- investment trustees manage the day-to-day operations of an investment account, helping it to grow over time;
- successor trustees are people who step in to manage a trust when the person who created the trust is unable to do so (through death or incapacitation);
- corporate trustees work with large firms that manage trusts for clients that pay them (other types of trustees are not always paid for their services like corporate trustes are); and
- bankruptcy trustees step in when a person or business declares bankruptcy and their assets need to be administered.

23 It should be noted that government and public sector units may also create trusts. This is very common, for example, in Latin America. In such cases, government or public

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[8] More generally, it can be noted that the criterion of autonomy of decision is often disputable, for example in the case of groups of related corporations, where the 2008 SNA is also less strict when it comes to autonomy of decision; see paragraphs 4.51 and 4.52 of the 2008 SNA.

[99] Please note that such a classification may also lead to having equity (F.51) as a liability in the accounts for sub-sector S.124, in addition to investment fund shares/units (F.52).

[10] Some of this guidance on the definition of trusts has been derived from a variety of websites.

sector units may also designate trustees which can be part, or not. of the public sector. Additionally, depending on the country legal framework, the trust might be created with a private nature, even when the risks and rewards remain with the government sector unit which created the trust. This should be analysed with care, on a case-by-case basis. In addition to the above decision tree for trusts and similar type of funds for the institutional unit test, the market/non-market test may need to be applied to determine the sector classification. Given these additional complexities, these government and public sector trusts are not further elaborated in this issues note. Instead, it is considered to draft a separate note on the treatment of these trusts.

24 Furthermore, the term “trust” is often used to designate other kind of corporate arrangements that are established following similar legal provisions. For example, in Australia family trusts are established to own corporations or to undertake business activities such as farms. Such trusts would probably qualify as a quasi-corporation, either or not to be classified as a holding company in sub-sector S.127 Captive financial institutions and money lenders, or as part of one the corporations’ sectors. This particular type of trust will not be further discussed below. It is only noted here that the same criteria which are relevant for establishing a quasi-corporation in the case of large unincorporated family enterprises, i.e., the availability of sufficient information to compile a complete set of accounts, and the point that it is operated as if it were a separate corporation, whose de facto relationship to its owner is that of a corporation to its shareholders; see paragraph 4.42 of the 2008 SNA.

25 Moreover, as noted before, in paragraph 10, the term trust is also used in the context of “unit trust” or “investment trust”, which refers to a type of investment fund where a trust structure is being used. These trusts are not part of the discussion in this issues note per se, although they implicitly feature in Section V, when discussing investment funds. Here, trusts mainly refer to units set up by individual settlors, be it individual households or individual corporations. As such, they are always a kind of captive financial institution, generally with no access to other beneficiaries beyond the ones assigned as such during the set-up of the trust.

26 Finally, in some countries, pension schemes may be set up as collective trusts. An example relates to funded employee pension schemes in the United Kingdom. These trust-type arrangements are also excluded from the discussion in this section. They are covered in Section VI, where pension schemes are discussed.

27 Coming back to trusts more generally, the trustee typically holds legal ownership of the assets held in the trust, although the assets constitute a separate fund, and are not a part of the trustee’s own assets. As such, the funds are clearly separated from the one administering and managing the trust. The trustee can take care of the administration and management of the trust, for a fee; or they can outsource the management to another financial service provider, also for a fee. Often trusts are set up for purposes of tax avoidance and evasion, which may concern income taxes, inheritance taxes and the like.

28 To put it in slightly different words, trusts are not legal entities themselves. Rather trusts constitute legal obligations on a person or another economic agent – the trustee – to hold assets for the benefit of beneficiaries. Although trusts are not legal entities, trusts are usually treated as separate units, including for tax purposes. All trusts typically share the following basic characteristics[11]:

- Trustee(s): Trustee(s) are responsible for managing the trust and holding the trust assets in their own name. The trustee, or trustees, may be a person or a company. If the trustee is a person, they must keep trust assets separate from the trustee's own assets. They may or may not be paid for the services that they provide and they may acquire services from others to assist them in managing the trust.
- Beneficiary/beneficiaries: Beneficiaries are those who benefit from the trust. They may have an entitlement to trust income or capital, or – in the case of a discretionary trust – they may acquire an entitlement because the trustee exercises a discretion to pay them income or capital. Unless they are also trustees, beneficiaries typically have no say in the operations of the trust, the exception being a bare trust where there is only one trustee, one beneficiary and no specified obligations, in which case the beneficiary has full control of the trust.
- Trust deed (agreement): The trust deed specifies the nature of the trust and its beneficiaries and how the trust is to operate for the benefit of the beneficiaries.

29 The main problem when it comes to the current guidance in the 2008 SNA is that, according to paragraph 24.75 of the 2008 SNA, trusts set up by households are considered as institutional units by convention. This is inconsistent, or at least raises questions on the consistency, with the guidance on captive financial institutions provided in paragraphs 4.59 – 4.61, which basically says that the institutional unit test needs to be applied to, amongst others, units used for holding and managing wealth for individuals or families. It is also inconsistent with the treatment of trusts set up by corporations. As noted in paragraph 4.64 of the 2008 SNA, if such trusts "*do not satisfy the definition of an institutional unit in the SNA, because they lack the ability to act independently from their parent corporation and may be subject to restrictions on their ability to hold or transact assets held on their balance sheet*", they should not be treated as such, but be considered as an integral part of the parent, the accounts of which should be consolidated with those of the parent, unless they are resident in another country.

30 Looking more specifically at trusts set up by households, the trustee is not the economic owner of the assets. The trustee may be the nominal/legal owner of the assets, but the accumulated assets in the trust constitute a separate fund and are not a part of the trustee's own assets, indicating that economic ownership is different from nominal/legal ownership. The main responsibilities of the trustee are to manage and administer the assets of the trust for the benefit of the beneficiaries. As such, they are not exposed to the risks

[11] In addition to what is stated below, you may also have so-called "trust protectors" in the case of, for example, special needs trusts, These protectors are appointed by the trustee/settlor of a trust, and may, or may not, be paid for their services. This is not further elaborated, as it does not have a material impact on the issues under consideration.

and the rewards of the accumulated assets. On the other hand, the trust itself does not constitute a legal unit per se, although it is often considered as a separate unit.

31 Disregarding the issue of a trust(ee) being resident in another country, as a consequence of which it would automatically be treated as a separate (notional) institutional unit, one could basically distinguish three options for recording the trusts:

a) Never treat the trust as an institutional unit and assign all trust assets and the income derived from these assets to the beneficiaries.
b) Treat the trust always as an institutional unit.
c) Only treat the trust as an institutional unit when the trustee is not exposed to the risks and the rewards and in the case of multiple beneficiaries, while in the case of a single beneficiary the accumulated assets are assigned to the beneficiary.

32 From a conceptual point of view, it is recommended to apply the third option, in line with the decision tree proposed in Section III. Trusts with multiple beneficiaries would then be classified as part of sub-sector S.124 Non-MMF investment funds, or, probably in very rare cases, as part of sub-sector S.123 Money market funds. An alternative is to classify these trusts, notwithstanding them having multiple beneficiaries, as captive financial institutions (S.127), because right from the start they typically constitute locked-in arrangements with no openness at all to other participants. Here, it is recommended to classify them as investment funds because from an economic substance point of view these multiple beneficiary family trusts are very similar to investment trusts, although they likely have a fewer number of beneficiaries. Non-resident trusts with single beneficiaries would always qualify as captive financial institutions (S.127).

33 A special case concerns the individual pension trusts, very popular in a number of Anglo-Saxon countries, where employers also make contributions as part of their arrangements with employees. This feature of employers making contributions as part of the employment package raises the question whether or not these schemes qualify as social insurance, which would also have an impact on the recording of these trusts. According to the decision tree, these trusts should be consolidated with the individual household deriving income from the assets accumulated in these trusts. However, if these trusts are indeed to be considered as a special type of social insurance arrangement, the consolidation with their owners would also lead to a consolidation of payments out of the accumulated assets, which would normally be recorded as pension benefits. This would run counter to a full recording of social insurance, and one may prefer to isolate these trusts and consider them as separate institutional units, also because they are part of a collective arrangement. The treatment of this special type of trusts will be dealt with in another issues note on the delineation of social insurance.

34 Finally, when it comes to the trustees, one may encounter two different cases. The trustee is either an individual household, who may or may not compensated for managing the trust, and who may or may not involve financial auxiliaries in the management and administration of the trust. Or the trustee is represented by a trust company who take care of the management and administration of the trust. Whatever the case, any fees paid to the trustee would represent income for the trustee, paid by the beneficiary, or beneficiaries, for the services provided – to be classified as financial auxiliary services. The trustees would

normally be classified as part of sub-sector S.126 Financial auxiliaries, unless it is a secondary activity of, for example, a law/accountancy firm or an individual lawyer/accountant. In practice, one may encounter problems in measuring this activity when it concerns individual household trustees for whom the management of a trust represents an insignificant activity.

Section V: The treatment of investment funds and other asset management arrangements

35 The institutional unit test is far less controversial for investment funds than in the case of trusts. Basically, investment funds always constitute separate institutional units, if only because of having multiple investors/beneficiaries. Management and administration of the funds may occasionally be provided internally but is usually outsourced to specialised agents, be it separate institutional units (to be classified as financial auxiliaries (S.126) or part of, for example, banks (to be classified as secondary activities of the relevant institutional units).

36 However, some arrangements may raise questions, and further clarifications are considered useful. Four issues are discussed here: (i) the treatment of fund-of-funds; (ii) investment funds set up and/or owned by another institutional investor; (iii) the treatment of asset management by banks; and (iv) the classification of real estate investment funds.

37 Regarding the first issue, the treatment of fund-of-funds, the question arises whether this is to be considered as one institutional unit, or multiple separate investment funds. Here, it may be useful to make a distinction between "fettered" fund-of-funds, which only invest in funds that are managed and administered by the same management company, versus "non-fettered" funds, which invest in any fund, even those managed by competing companies. The question of consolidation only arises in the former case, as in the latter case one is clearly dealing with different institutional units.

38 In the case of "fettered" fund-of-funds, the fund-of-funds and the individual funds would typically share the same management company, to be classified in sub-sector S.126 Financial auxiliaries. However, this would not necessarily call for a consolidation of the fund-of-funds and the individual funds, because the latter may also have shareholders other than the fund-of-funds. A particular case would be one in which a fettered fund-of-funds invests in individual funds with no participation, as shareholders, by third parties. In such a case, one could argue in favour of consolidation, but one may wonder about whether such fund-of-funds are existing.[12]

39 The second issue concerns the treatment of investment funds which are set up and/or owned by another institutional investor, such as a pension scheme. In some countries, pension schemes may have "outsourced" part of the investments of their

[12] As an example, one could think of a fund management company which deploys a strategy for the specialisation of its staff supported by layered funds, e.g., fund A invest in the housing market in China, fund B in space economy corporations and fund C in European sovereign debt, while the fund-of-funds α, offered to their clients, invest in A, B and C with varying weights.

accumulated assets to fully owned investment vehicles with a separate legal status, resident as well as non-resident[13]. They also may have set up specialised vehicles for administration and asset management, also providing this type of services to other pension funds.

40 More generally, one could argue that these investment vehicles have separate legal status, and therefore could be treated as separate institutional units, in line with paragraphs 4.51 and 4.52 of the 2008 SNA. However, one could raise the question whether these investment funds actually have autonomy of decision, most certainly if they only consist of a separated fund without any employees, with the asset management being outsourced. Whatever the case, for investment vehicles, autonomy of decision would primarily concern the degree of autonomy in making decisions on the investment policy, either or not restricted by more general policy guidance. Paragraphs 4.60 and 4.61 of the 2008 SNA then seem to be applicable, although – as noted before – these paragraphs leave quite some room for interpretation, with the former paragraph stating that a unit should be treated as an institutional unit if it exercises substantive control and carries the risks and reaping the rewards, versus the latter paragraph stating that a unit not being able to act independently and being on auto-pilot should be consolidated.

41 Here, two options are put forward for consideration:

A. Use as a default position that the investment fund should be consolidated with the investor, if the investment fund only serves a single investor, unless the fund clearly has autonomy of decision. In the case it concerns a non-resident fund, then it should be classified in sub-sector S.127 Captive financial institutions and money lenders. This follows the decision tree proposed in Section III, and can also be considered as being broadly consistent with paragraphs 4.60 and 4.61 of the 2008 SNA. It is also like the case above of “fettered” fund-of-funds, which owns 100% of the investment fund shares of the funds under its control.
B. Use as a default option that the relevant funds are to be treated as separate institutional units, because one may assume that these funds constitute separate legal entities, unless there is clear evidence that the relevant funds are on auto-pilot. In the former case, they would be classified as part of S.123 or S.124, while in the latter case they would be consolidated with the parent company. In case it concerns a non-resident fund, they would always be treated as a separate institutional unit. However, in case the fund is to be considered as being on auto-pilot, they would be recorded in S.127. This treatment would be more in line with paragraphs 4.51 and 4.52 of the 2008 SNA.

Overall, it is recommended here to apply option A, in line with the decision tree in Section III.

42 Thirdly, regarding the treatment of asset management by banks, one can think of households outsourcing the management of their funds to banks. The banks would typically use these funds to invest in certain standard portfolios, running from defensive investment strategies to very offensive strategies. Here, it is critically important to know who bears the risks and rewards. If the bank is exposed to the risks of the assets they are managing, then

[13] In The Netherlands, for example, the pension scheme for civil servants, one of the largest institutional investors worldwide, has a 100% ownership of quite a number of, resident as well as non-resident, investment vehicles with a separate legal status.

this should be considered as financial intermediation, and the corresponding assets (and liabilities) should be consolidated in the accounts of the bank.

43 However, more frequently, the risks and rewards of the assets managed are with the investor(s). In these cases, the assets should be consolidated with the accounts of the investor, if it concerns a single institutional unit (e.g., if the asset management is customised to the client, like in "managed accounts" of private banking services to wealthy clients), or a separate institutional unit, to be classified in either S.123 or S.124, should be distinguished, assuming that the relevant assets (and liabilities) can be separated out (e.g., for more retail oriented products). In both cases, the bank would be preforming asset management activities, as a secondary activity.

44 Finally, the treatment, and especially the classification of real estate investment funds may need further clarification. Paragraph 4.108 of the 2008 SNA states that investment funds may invest in real estate. However, the Manual on Financial Production, Flows and Stocks in the System of National Accounts (MFPFS) states, in bullet c of paragraph 2.23, that "*real estate investment trusts … invest in debt and equity instruments of companies that purchase real estate*", which excludes having non-financial assets on the balance sheet of investment funds. One could see the possibility of having rental services as a secondary activity of investment funds, and for that matter also as a secondary activity of pension funds, but what about such funds providing this type of services as a primary activity?

45 Here, it is recommended that investment funds which own, and rent out, dwellings and/or commercial property, are classified as providers of rental and other types of real estate services, and not as financial corporations[14]. These funds may outsource all administration and maintenance services to other providers but their output would still primarily consist of producing real estate services. On the other hand, investment funds who primarily invest in debt and equity instruments in companies which own, and rent out, dwellings and/or commercial property would qualify as non-MMF investment funds (S.124)[15]. If agreed, a clarification to this effect will need to be added to the updated 2008 SNA, in line with MFPFS.

Section VI: The treatment of pension schemes

46 The institutional unit test for pension schemes (i.e., life-insurance type of arrangements which qualify as social insurance) is related to, but also quite distinct from what has been discussed in Sections III to V for trusts and similar type of funds. The difference concerns the actors involved. While in the case of trusts and similar type of funds, there are two actors, the fund manager and the beneficiary(ies)/investor(s), another actor is also relevant for the discussion on whether or not a pension scheme should be treated as a separate institutional unit: the economic agent who is responsible for any shortfall, or

[14] It should be noted that government may also create such funds, and may bear the risks and rewards. In these cases, the market/non-market assessment should be done and the adequate sectorization be applied (general government or non-financial public corporation).

[15] In the case of hybrid real estate investment funds, the classification would depend on its primary activity.

surplus, of accumulated assets as compared with the amount of pension entitlements (the scheme's pension liabilities).

47 Before discussing the issue of institutional units for pension schemes, it is considered important to explain in detail the various agents involved in these schemes, including the terminology used in this issues note. First, the term "pension schemes" is used to refer to all pension arrangements, be they funded or unfunded. A "pension fund" is more limited, as it only concerns pension schemes in which assets are accumulated for the future payment of pension benefits (funded or partially funded pension schemes).

48 Looking at the economic agents involved in pension schemes, first of all one can distinguish the beneficiaries, i.e., the people building up entitlements, and the people in retirement receiving benefits from entitlements built up in the past.

49 The second agent, which is relevant for defined benefit schemes, is the unit that is responsible for any shortfall of the accumulated assets compared with the entitlements (the pension deficit). In the 2008 SNA, this second agent is referred to as the pension manager. This role is typically played by an individual employer.[16] However, there are also cases in which the responsibility for shortfalls is less clearcut. An example relates to multi-employer pension schemes, or cases where shortfalls may be distributed between the employer, the employees and the people in retirement. Moreover, an insurance corporation can also run the risks of any shortfalls (or receive the rewards), when the entitlements are larger (smaller) than the accumulated assets. Often this latter type of arrangements will relate to annuity-type schemes for certain groups of employed or previously employed people.

50 Finally, one can distinguish the administrator of the pension scheme, the one who takes of all administration and arranges the investment of accumulated funds. Here, one can also observe various modalities. The administration of the scheme could be organised by the staff of a pension scheme or staff of the employer, by an insurance corporation or another financial institution, or it can be, partially or fully, outsourced to a financial auxiliary. The latter would be classified as part of sub-sector S.126 Financial auxiliaries and money lenders.

51 The use of the above terms may be slightly confusing, when comparing them to the terms used for trusts and similar type of funds, where the term fund manager is used to refer to the unit responsible for the investment of the accumulated funds, including often the administration. To avoid confusion, the term "pension manager/sponsor" is occasionally used in the following paragraphs, to clearly distinguish the role of this economic agent from the role of a fund manager.

52 Apart from the differences in economic agents involved and the terms used for them, an important additional consideration for determining whether a pension scheme

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[16] In several countries, the government organises (employment-related) pension schemes for (large parts of) the employed persons. This will not be dwelt upon in this issues note. The discussion will focus on employment-related schemes sponsored by employers, including the government as an employer, and other types of arrangements outside government.

constitutes a separate institutional unit is the fact that in many countries pension systems are highly regulated and supervised, often requiring specific rules about the segregation between sponsors and the pensions for which they may be responsible.

53 As explained in Section II of this issues note, the 2008 SNA hardly contains any specific guidance on the delineation and classification of pension schemes. Paragraphs 4.116 and 17.131 provide some guidance but lack clear rules about the preferred treatment. Whatever the case, building on these paragraphs and the more general recommendations on the delineation and classification of institutional units that can be derived from the 2008 SNA, the following is recommended for the update of the 2008 SNA.

54 First of all, in line with paragraph 17.131 of the 2008 SNA, a distinction can be made between defined contribution schemes and defined benefit schemes. Apart from a few examples of notional defined contribution schemes (see below), the former always have a fund, while for the latter this may not be case, as they may be unfunded or (partially) funded. More importantly, in the case of defined contribution schemes, risks and rewards are entirely allocated to beneficiaries. Therefore, in the discussion below, a distinction is made between these two types of schemes. In line with this discussion, two decision trees are presented, one for defined contribution schemes and one for defined benefit schemes. In doing so, hybrid schemes, which are neither a full defined benefit scheme nor a full defined contribution scheme, but have some of the characteristics of each, are implicitly included under defined benefit schemes.

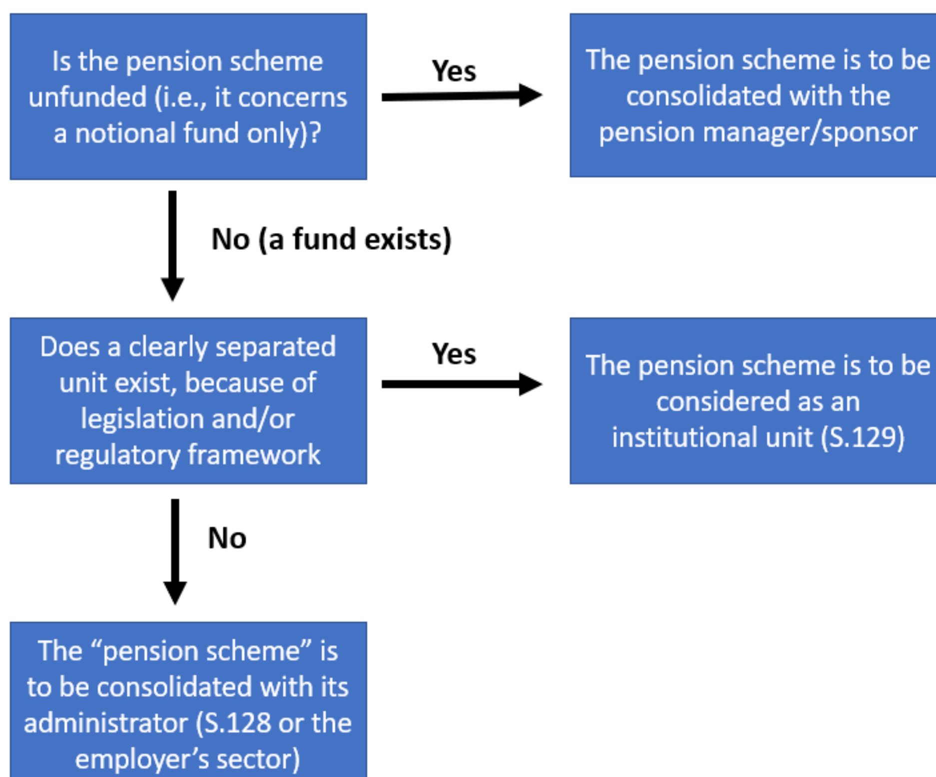
55 On the next page, the decision tree for the institutional unit test for defined contribution schemes is first presented. Although in practice not relevant in most countries, the first question to be raised is whether a fund in the form of accumulated assets exists. This may not be the case for so-called "notional defined contribution schemes". As explained in paragraph 17.61 of ESA 2010: "*In a notional defined contribution scheme, contributions (both from employee and employer) are credited to, and accumulated on, individual accounts. Those individual accounts are notional, in the sense that the contributions to the schemes are used to pay pension benefits to current pensioners. At retirement, the accumulated balance is converted into an annuity through a formula, based, among other factors, on a measure of life expectancy, and is revised annually to catch up with a measure of the standard of living*".[17] Basically, this means that no assets are accumulated, although the entitlements are based on actual contributions plus some form of return, either fixed or based on the actual returns on some predetermined portfolio of assets.

56 Such notional defined contribution schemes cannot be regarded as separate institutional units and would thus – following the decision tree – be consolidated with the pension manager/sponsor, usually the employer providing such a pension scheme. One may also argue that the same holds for other exceptional cases where evidence shows that the

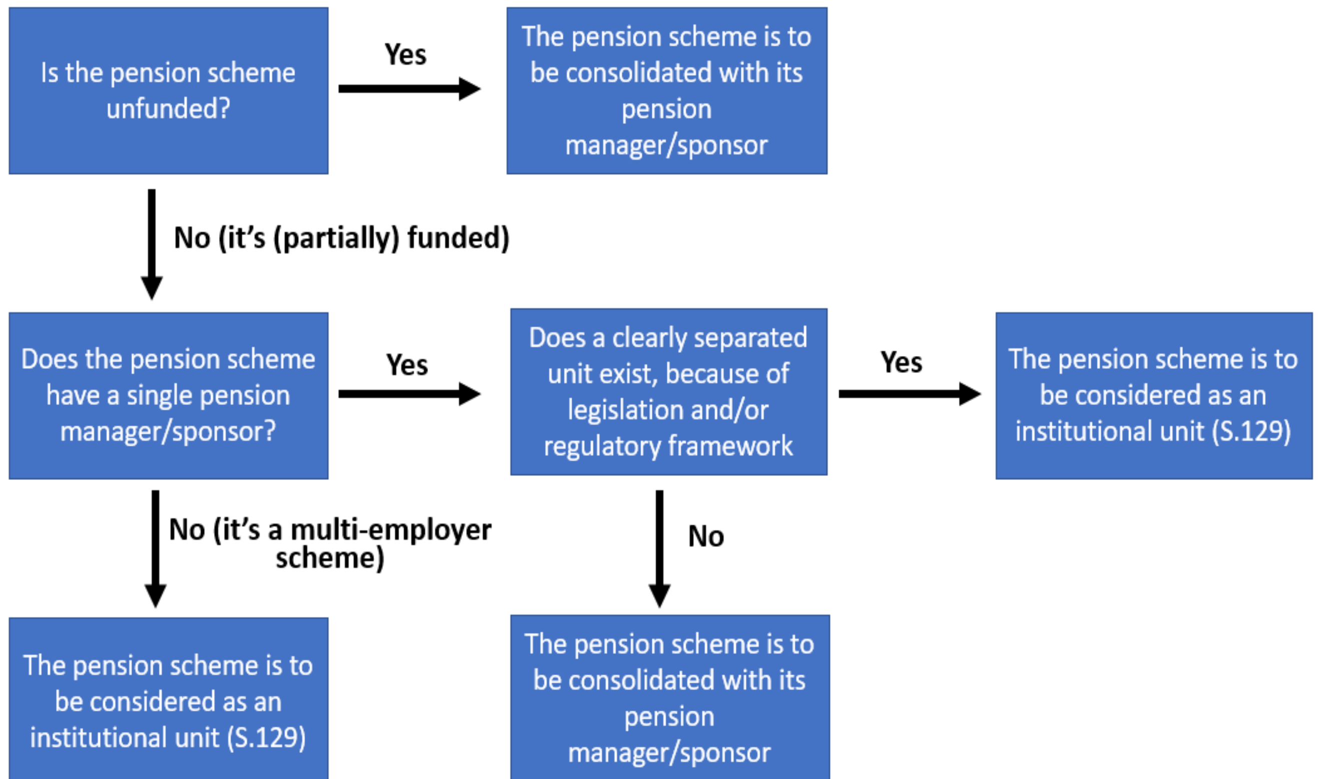
[17] Please note that in ESA 2010 notional defined contribution schemes are grouped together with defined benefit pension schemes.

scheme is not truly funded because the accumulated assets consist of the employer's own shares, as was the case for the pension scheme of Enron.

57 For the funded defined contribution schemes, often clearly separated units exist due to legislation and/or a regulatory framework. If this is the case, it is recommended to treat these as separate institutional units. If this is not the case, the "pension scheme" should be consolidated with its administrator.



58 For defined benefit schemes, the landscape is more diverse, as shown in the decision tree on the next page. First, similar to the defined contribution pension schemes, one can make a distinction between unfunded schemes and (partially) funded schemes. Whether or not the related entitlements are recognised in the system of national accounts, the former schemes would never qualify as an institutional unit, as they only consist of a set of promises for payment of future benefits, with no funds linked to them. They would thus be consolidated with the pension manager/sponsor, typically the employer responsible for the scheme.



59 For (partially) funded defined benefit schemes, the question then arises whether or not there is a single pension manager/sponsor, or multiple pension managers/sponsors (a multi-employer pension scheme). In the latter case, unless the multi-employer pension scheme is managed by an insurance corporation, which also takes the risk for any shortfalls, or alternatively get the receipts from any surplus (see below), it can be assumed that a separate institutional unit exists, to be classified in sub-sector S.129 Pension funds.

60 For defined benefit pension schemes with a single pension manager/sponsor, the question arises whether a clearly separated unit exists, due to legislation and/or regulatory framework. If the answer to this question is affirmative, the unit would be classified as a separate institutional unit, again to be classified in sub-sector S.129. If the scheme is not clearly separated, the pension scheme would be consolidated with its pension manager/sponsor. The sponsor/manager could be the employer, or an insurance corporation – the latter particularly in the case of pension annuities.

61 One could argue, following the decision tree for trusts and similar types of funds, that in the case of pension schemes with a single pension manager/sponsor, the risks and rewards are with the pension manager/sponsor, and therefore the pension fund is to be considered as a non-autonomous fund, to be consolidated with the employer, or whoever is liable to cover the shortfalls. However, due to legislation, these schemes or funds are often clearly separated from the sponsor, with a separate board of directors or pension scheme trustees taking decisions about, for example, investment policy, and where arrangements

around contributions and benefits are part of negotiations between employer, employees and retirees.

62 Apart from these more traditional types of pension scheme, one can also observe a number of other arrangements. First, there may be single-employer defined benefit schemes where the responsibility for any shortfalls is shared between the employer and the beneficiaries, and where any surplus/shortfall leads to positive/negative net worth of the relevant fund. Such an arrangement would make the case for distinguishing a separate institutional unit even stronger, as compared with the case of a single-employer pension scheme with an undisputable pension manager/sponsor.

63 As already alluded to, there may be multi-employer pension schemes managed by an insurance corporation which also takes the risk for any shortfalls, or alternatively receives any surplus.[18] [19] This case is relatively straightforward. The 2008 SNA provides explicit guidance in paragraph 17.92, where multi-employer schemes defined as follows: "*An insurance corporation may, for a fee, agree not only to manage a pension scheme but to take on the risks associated with it. This is done in the context of performing this service for a number of schemes collectively under what is called a multi-employer scheme. Under many such schemes, the insurance corporation takes over the responsibility of managing the funds at its disposal so as to make sufficient funds available to meet pension liabilities and to make a surplus it can retain. If it fails to make sufficient funds available for the pension entitlements, it is then the responsibility of this firm and not the original employers, to make good the difference from its own resources*". In line with this guidance, it looks most logical not to treat such a pension scheme as a separate institutional unit, but instead to consolidate it with the insurance corporation. However, for these type of arrangement, one could also follow the decision tree for classifying pension schemes with a single pension manager/sponsor, albeit in this case for multiple defined benefit pension schemes.

64 Finally, when it comes to multi-employer pension schemes, the 2008 SNA sometimes only seems to refer to the multi-employer schemes managed by insurance corporations, in addition to those provided by government (see e.g., paragraphs 6.201, and 17.92 – 17.93), although it should also be acknowledged that paragraph 17.122 and especially paragraph 17.164 provide room for a broader interpretation. Whatever the case, there are clear and obvious examples of separate units providing multi-employer pension schemes where the responsibility for any shortfall is shared between the sponsors and/or the beneficiaries, and where any surplus or shortfall lead to positive or negative net worth of the relevant unit. Such funds clearly constitute separate institutional units, if only because the risks and rewards are distributed across different actors.

[18] The existence of such defined benefit schemes may be rare in practice, although one could see the possibility of annuity type of schemes offered by insurance corporations.

[19] Insurance corporations may also be the manager of (multiple) single-employer pension schemes. However, these cases are excluded here, as the insurance corporation can be looked upon as a provider of auxiliary services, and the relevant pension schemes should be separated from its pension manager/sponsor.

Section VII: Conclusions and main recommendations

65 This issues note contains a further elaboration of what constitutes trusts, including the reasons for setting up trusts. In addition, a decision tree has been provided for the institutional unit test of trusts, which is also considered applicable for investment funds. Furthermore, a separate section contains a further elaboration of the institutional unit test for pension schemes, with two decision trees, one for defined contribution pension schemes and one for defined benefit pension schemes. For trusts, investment funds as well as pension schemes, special cases have been addressed.

66 More specifically, it is recommended to provide additional guidance on trusts, and the consideration for treating trusts, investment funds and pension schemes as separate institutional units, in the update of the 2008 SNA. More general guidance could be provided in SNA 2025 Chapter 5 on Residence, institutional units and sectors, while more detailed guidance could be added to SNA 2025 Chapter 24 Insurance and pensions and Chapter 29 on Financial corporations. Where relevant, guidance in other chapters may also need to be updated.

67 In addition to the above general update of the guidance, it is recommended to add guidance on the treatment of specific cases, in particular real estate investment funds, asset management provided by banks, and multi-employer pension schemes; and to update the guidance on quasi-corporations to also account for those which are set up as a trust.

68 Finally, it is recommended to do additional research on individual pension trusts, especially whether they constitute a social insurance type of scheme which may warrant a treatment distinct from other trusts. This research could be dealt with in the planned issues note on Action point A.13: Address the current ambiguities and inconsistencies regarding the recording of social security and employment-related schemes, and the current guidance for constructive liabilities (see para. 3.34 and 3.40 of the 2008 SNA).