Towards the 2025 SNA and BPM7

Issues note on action point A.6: Treatment of trusts and similar types of funds as separate institutional units

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Introduction (1)

Paragraphs A4.14 and A4.15 of the 2008 SNA state the following:

> *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****.*

Two main issues:

- **Defining trusts**: Issues note includes some explanations, which could be helpful in providing a more detailed description, including the definition already included in BPM6
- **When, and when not, to treat trusts as separate institutional units**: main topic of this presentation

Introduction (2)

- In some countries, **trusts are used in a variety of arrangements**
- Necessary **to broaden the issue**, by also looking more generally at the treatment of funds, in which assets are accumulated and several agents managing and/or administrating and benefiting from these funds are involved. This primarily relates to **investment funds and pension schemes**
- However, **some specific cases have been excluded:**
  - **Trusts set up by government**: separate issue note considered
  - **Large family trusts established to own corporations or to undertake business activities**: same criteria which are relevant for establishing a quasi-corporation in the case of large unincorporated family enterprises
  - **Individual pension trusts where employers also make contributions**: qualification as part of social insurance would have an impact on the recording; further investigation needed, as part of an issues note on social insurance, still to be drafted

Introduction (3)

- **Current guidance**
- **Decision tree for the institutional unit test for trusts and investment funds**
- **Special cases**, especially related to investment funds
- **Decision tree for the institutional unit test for defined contribution schemes and defined benefit schemes**
- **Special cases** related to pension schemes
- **Summary of recommendations**

Current guidance on the treatment of trusts (1)

The 2008 SNA contains somewhat conflicting messages:

- When defining **quasi-corporations**, paragraph 4.43 of the 2008 SNA also refers to trusts: *unincorporated enterprises, including unincorporated partnerships or **trusts**, owned by households that are operated as if they were privately owned corporations*
- 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***
- However, the 2008 SNA is much **more restrictive when it comes to trusts set up by corporations** for similar reasons to subsidiary corporations. Paragraph 4.65 notes that ***these are also treated as an integral part of the parent and their accounts are consolidated with the parent***

Current guidance on the treatment of trusts (2)

- Furthermore, 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***, paragraphs 4.60 and 4.61 provide further guidance on whether these units are to be considered as separate institutional units:
  - *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*
  - *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) is not treated as a separate institutional unit*** *unless it is resident in an economy different from that of its parent*
- Finally, paragraph 11.96 contains a short reference to **investment funds set up using a trust structure**

Current guidance on the treatment of trusts (3)

Guidance provided in the Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG) is quite different. Paragraph 3.184 of this manual 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 economy to that of any of the beneficiaries; or (2) otherwise satisfy the definition of a quasi-corporation*

Current guidance on the treatment of other funds

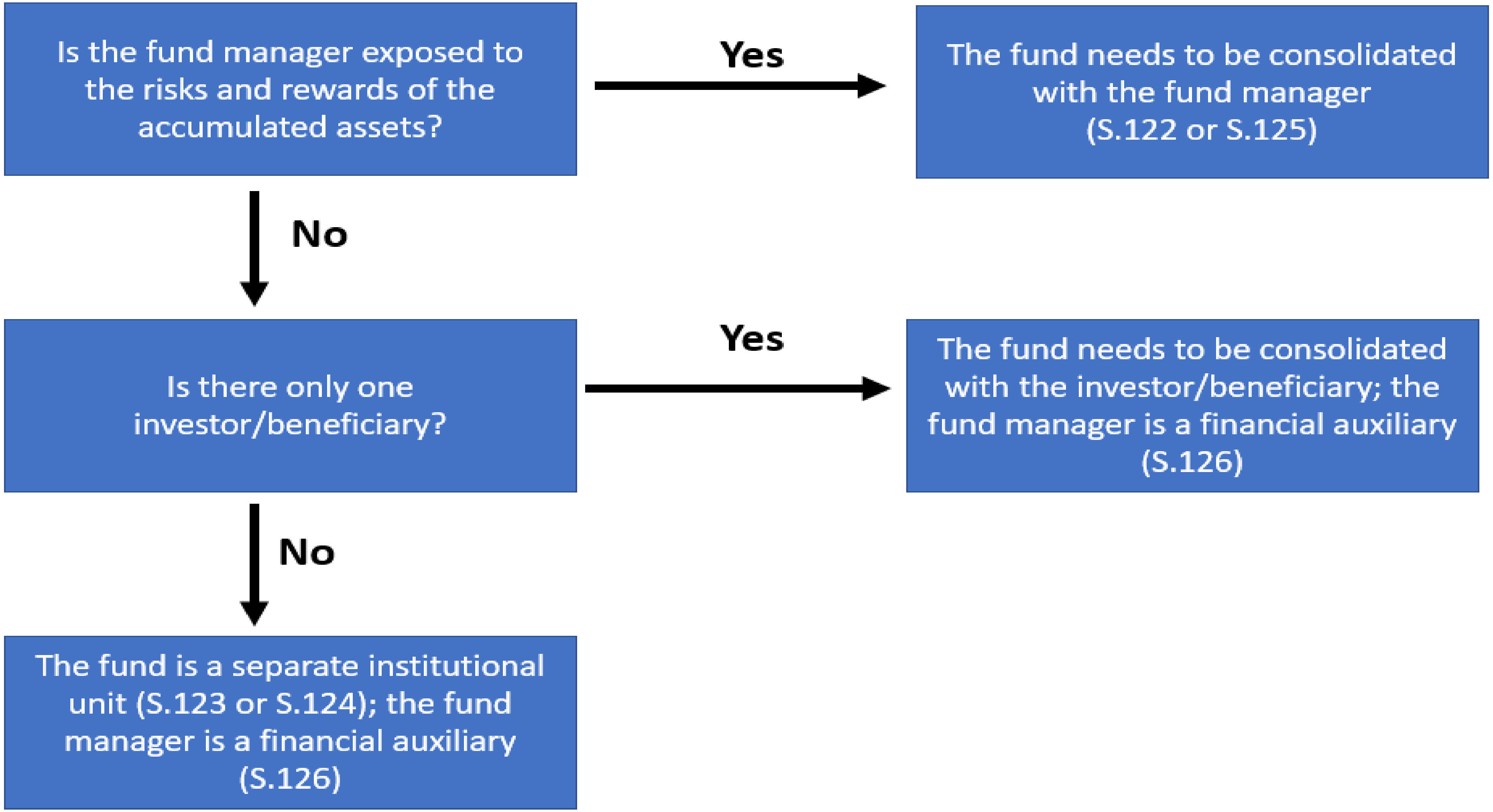
- No specific guidance provided in the 2008 SNA
- Regarding investment funds, both the 2008 SNA and the Manual on Financial Production, Flows and Stocks in the System of National Accounts (MFPFS) provide a listing of **financial auxiliaries, thereby also including *managers of pension funds, mutual funds, etc. (but not the funds they manage)***, which one could interpret as suggesting that the relevant funds and the managers of these funds need to be separated
- For pension schemes, only **paragraph 17.131** of the 2008 SNA provides some guidance, but this **could be interpreted in different ways**. 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***

Decision tree for the institutional test for trusts and investment funds (1)

One can typically distinguish **three economic agents** involved:

- the **fund** itself
- the **beneficiary/beneficiaries** of the proceeds derived from the accumulated assets (in the case of investment funds: investor(s))
- the **manager of the fund**, who primarily takes care of the administration, including the investment decisions of the fund, and who may or may not be the one running the risks and receiving (some of) the rewards

Decision tree for the institutional test of trusts and investment funds (2)



Special cases for trusts and investment funds (1)

- Special cases for trusts have already been excluded from the analysis
- However, **for investment funds** the following special cases have been distinguished in the issues note:
  - **Fund-of-funds**
  - **Investment funds owned by a single investor**
  - **Asset management by banks**
  - **Real estate investment funds**

Special cases for trusts and investment funds (2)

Fund-of-funds

- One institutional unit, or multiple separate investment funds?
- Distinction between **“fettered” fund-of-funds**, which only invest in funds that are managed and administered by the same management company, versus **“non-fettered” fund-of-funds**, which invest in any fund, even those managed by competing companies.
- The institutional unit question only arises in the former case, as in the latter case one is clearly dealing with different institutional units
  - If the **individual funds have shareholders other than the fund-of-funds**, one could argue in favour of distinguishing separate institutional units
  - If the **individual funds do not have third-party participants, as shareholders**, one could argue in favour of consolidation

Special cases for trusts and investment funds (3)

Investment funds owned by a single investor

- The funds typically have **separate legal status**, but …
- … **do they have autonomy of decision**, especially in the case of a separated fund without any employees, with the asset management being outsourced?
- Two options are put forward for consideration
  A. Default position: **Consolidate the investment fund with the investor**, unless the fund clearly has autonomy of decision
  B. Default position: **Treat the relevant fund as a separate institutional unit**, because one may assume that these funds constitute separate legal entities, unless there is clear evidence that the relevant funds are on auto-pilot
- It is recommended to apply **option A**

Special cases for trusts and investment funds (3)

Asset management by banks

- Households outsourcing the management of their funds to banks, which typically use these funds to invest in certain standard portfolios
- **Who bears the risks and rewards?**
  - If the **bank is exposed to the risks and rewards** of the assets, then this should be considered as financial intermediation, and the corresponding assets (and liabilities) should be **consolidated in the accounts of the bank**
  - However, if the **risks and rewards of the assets are with the investor(s)**, the assets should be consolidated with the accounts of the investor, if it concerns a **single investor**, or treated as a separate institutional unit in the case of **multiple investors** (assuming that the relevant assets (and liabilities) can be separated out)

Special cases for trusts and investment funds (4)

Real estate investment funds

- First and foremost concerns the **classification**
- Para. 4.108 of the 2008 SNA states that investment funds **may invest in real estate**
- However, 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
- It is recommended to **classify investment funds which own, and rent out, dwellings and/or commercial property, as providers of rental and other types of real estate services**, and not as financial corporations; and to **classify investment funds who primarily invest in debt and equity instruments** in companies which own, and rent out, dwellings and/or commercial property **as non-MMF investment funds**

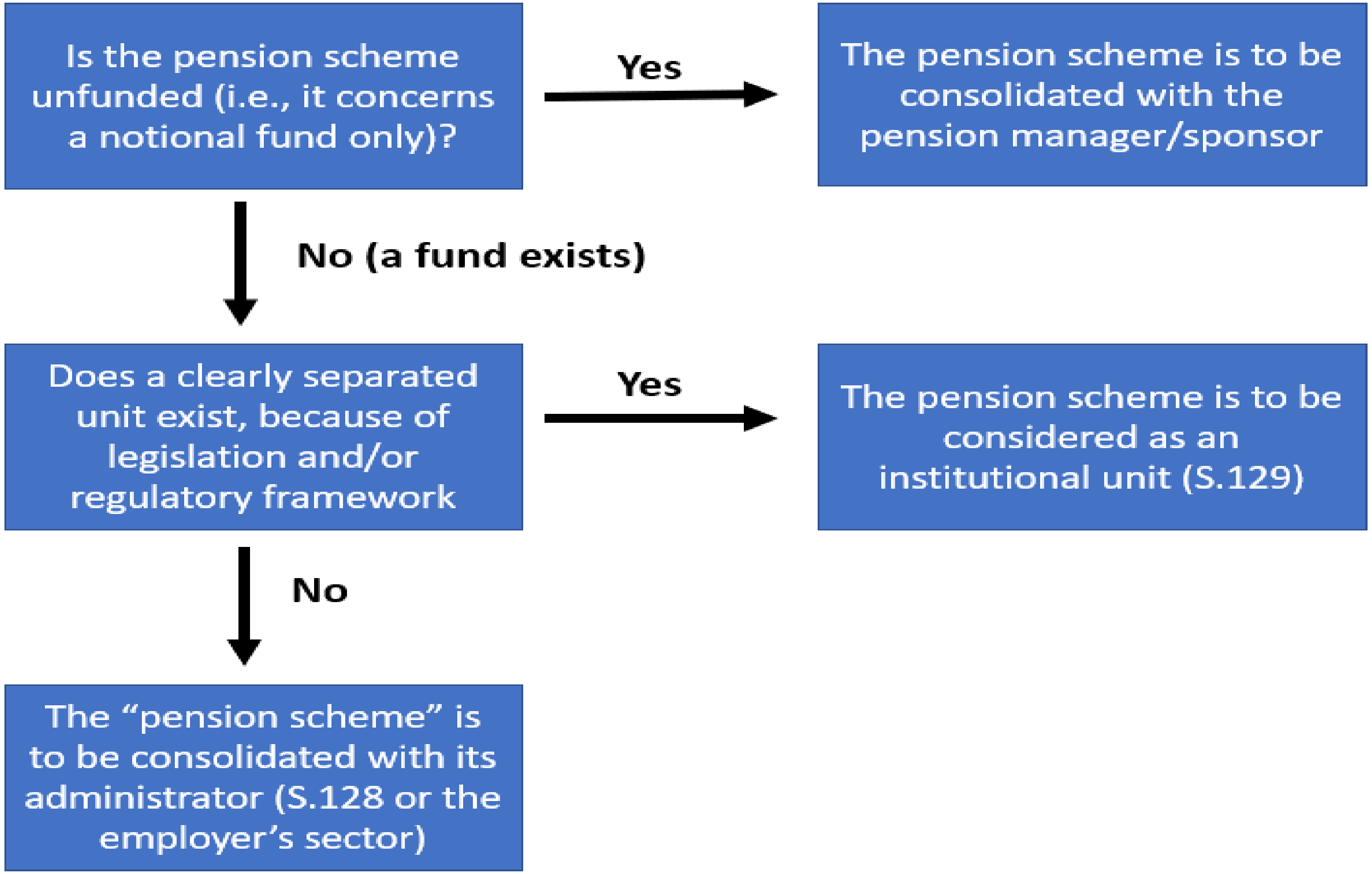
Decision tree for the institutional test for pension schemes (1)

Apart from the scheme/fund itself, one can distinguish **three economic agents** involved:

- **beneficiaries**, i.e., the people building up entitlements, and people in retirement receiving benefits from entitlements built up in the past
- In the case of defined benefit schemes, the **pension manager/sponsor**, i.e., the unit responsible for any shortfall of the accumulated assets compared with the entitlements (the pension deficit). This role is typically played by an individual employer, but there may also be cases in which the responsibility for shortfalls is less clearcut (e.g., multi-employer pension schemes, or cases where shortfalls may be distributed between the employer, the employees and the people in retirement). Also an insurance corporation can run the risks of any shortfalls (or receive the rewards)
- The **administrator** of the pension scheme, the one who takes care of all administration and arranges the investment of accumulated funds. This role could be played by the staff of a pension scheme or the staff of the employer, by an insurance corporation or another financial institution, or it can be, partially or fully, outsourced to a financial auxiliary

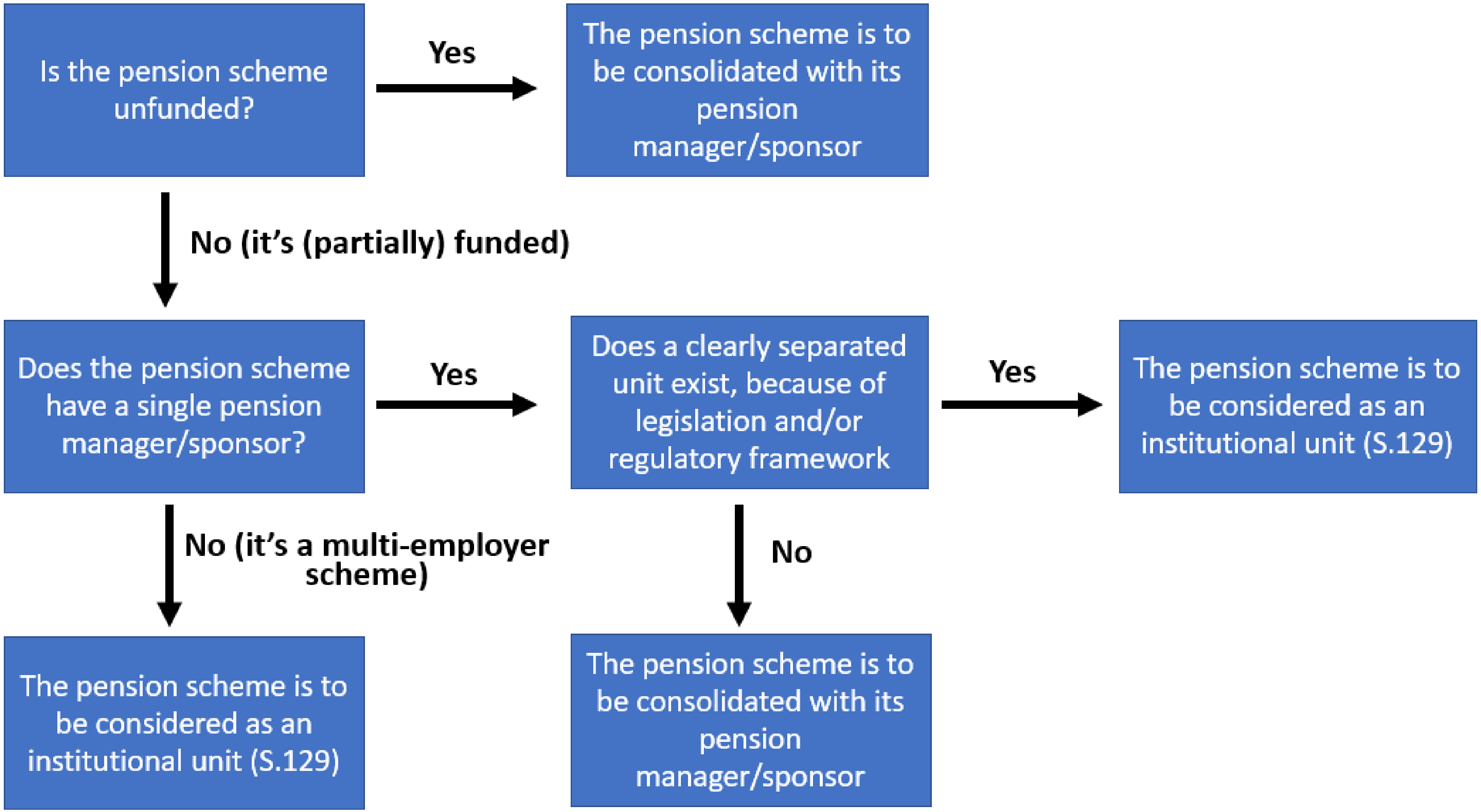
Decision tree for the institutional test of pension schemes (2)

Defined contribution pension scheme



Decision tree for the institutional test of pension schemes (3)

Defined benefit pension scheme



Special cases for pension schemes

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

- The case for distinguishing a **separate institutional unit** is even stronger, as compared with the case of a single-employer pension scheme with a single pension manager/sponsor

Multi-employer pension schemes managed by an insurance corporation which also takes the risk for any shortfalls, or alternatively receives any surplus

- In line with para. 17.92 of the 2008 SNA, such a scheme should **not be treated as a separate institutional unit**, but instead be consolidated with the insurance corporation

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 pension schemes clearly constitute **separate institutional units**

Summary of recommendations

- It is recommended to **provide additional guidance on trusts, and the the treatment of 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
- In addition to the above update of generic 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.
- 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

Thank you for your attention!