Comments on draft SNA chapter:

Chapter 4: Institutional units and sectors

Deadline for comments: 1 September 2007

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This three-part template allows you to record your comments on draft chapter 4 easily and, at the same time, makes it easy for us to use your comments in considering revisions to the draft chapter. You may complete any one, any two, or all of the three parts of the template.

Especially when providing comments in Part III of the template, you are encouraged to focus on the new passages of the draft text. To facilitate this process, a file comparing the existing text and the draft text is available on the website under the following link:
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Part I: General comments

In the space below, please provide any general comments, such as about the clarity with which the new recommendations were incorporated (30 words or less).

In comparison with the SNA93, there are interesting elements of clarification of the concepts of institutional units. Nevertheless, the current draft version of SNA Rev.1 is less structured than the old SNA93. It complicates the understanding for the reader and sometimes it leads to some confusion. This is particularly the case for the parts "A. Introduction" and "C. Non-profit institutions". In part A., the difference between the concepts of institutional units and institutional sectors is less clear than in the SNA93. In order to avoid this misunderstanding, please keep the previous "Table 4.1. Institutional units cross-classified by sector and type". As in the SNA93, we advise to incorporate the part "C. Non-profit institutions (NPIs)" into a part "B. Institutional units in the form of legal or social entities" because the current structure leads to some confusion. Moreover, it is foreseen to anyway describe the NPIs in more details in the new chapter 22 on “Non-profit institutions in the System".

1. Classification of sectors

The term *“public sector”*, which occurs several times in paragraph 4.69 (and occasionally elsewhere), is confusing. We think it would be better to avoid the term in this chapter. If it is used, the text should explain that the reference is not to an institutional sector in the meaning of the System, but to entities in the general government sector plus government-owned entities in the financial and non-financial corporations sectors or in the non-profit institutions serving household sector which remain classified in S.11, S.12 or S.15. Therefore, the issue of government control of corporations (and NPI) as described in paragraphs 4.64 to 4.70 and 4.82 and 4.83 might be much better placed in chapter 21 on the 'public sector and the general government sector.'

On *the allocation of units to institutional sectors (Figure 4.1)* we think that the illustration is very useful and agree with the decision tree but see options for further improvements: We think that the second part (on control) is not necessary in this chapter. It might more appropriate to present it in chapter 21. The questions raised in the decision tree should always first be answered with yes. Finally, the figure should also make a reference to the criterion of having "economically significant prices", which is mentioned e.g. in paragraph 4.15 as being fundamental. In addition, the criterion to define a unit as resident or non-resident may also be incorporated in the figure.

The term 'subsector' should in our view be confined to breakdowns which have a code number in the System, e.g. S.121, 122, etc., or S.1311, etc. Thus 4.29 does not mention subsectors in S.12 and S.13, but only (unnumbered) breakdowns in S.14 and the ownership distinctions made within S.11 and S.12.

2. Classification of financial corporations

The ECB was involved in the work on section E, the financial corporations sector and its sub-sectors. Following detailed discussions and a world-wide consultation one year ago, agreement was achieved to distinguish nine financial corporation sub-sectors. Section E appropriately reflects this outcome. However, some questions remain. They refer to the classification in general, the different treatment of holding companies, the specification and the sub-sectoring of institutional units like SPEs, SPVs or guarantee banks, and further details on insurance corporations and pension funds.

For instance, it may be useful to include a paragraph on the treatment of corporations used (and owned) by financial corporations to hold securities without having control of the companies on which they hold the securities (i.e. not being "holding" companies in the meaning of the SNA). This issue could have important implications and is not explicitly mentioned in the current text.

a. General comments on the classification of financial corporations

The approach distinguishes nine financial corporations sub-sectors. The first group comprises the central bank, deposit-taking corporations except the central bank and money market funds (MMFs), which may be combined to corporations incurring liabilities mainly as components of broad money. A second group of financial corporations covers the four sub-sectors non-MMF investment funds (they might be combined with MMFs if money market fund shares/units are not seen as broad money), other financial intermediaries except insurance corporations and pension funds (ICPFs), financial auxiliaries, and captive financial institutions and money lenders. The remaining sub-sectors, insurance corporations and pension funds, can also be combined, if so desired.

In general, the text explaining why the sub-sectorisation has been proposed in the way as outlined should be more explicit as also done for other sectors (like general government or households). For instance, it should be said (as expressed in paragraphs 4.152 and 4.153 for households) that *"there are many useful* *ways in which the [financial corporations sector] may be sub-sectored and statistical agencies are advised to give due consideration to the various possibilities."*[1] Accordingly, a specific method may be adopted depending on the demand from users, analysts or policy makers. The System has to be applied flexibly, not rigidly.

Accordingly, two proposals may be recommended: First, a sub-sectoring based on the use for monetary policy purposes. It distinguishes between monetary financial institutions, ICPFs and miscellaneous financial corporations. This sub-sectoring complies with the (slightly modified) ECB proposal made in the letter of 28 July 2006, which has the advantage to clearly specify the two main groupings of financial intermediaries covered by the sub-sectors monetary financial institutions and ICPFs. The split into three groupings 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 non-MMF investment funds.

It has to be reminded that the 1995 ESA foresees the sub-sector monetary financial institutions (MFIs) for statistical purposes as defined by the ECB (central bank, deposit-taking corporations except the central bank, and MMF) in order to guarantee consistency between the ECB monetary, financial market and financial statistics and the ESA financial accounts as well as other national accounts (such as interest payable and receivable). Due to the importance of this specification for many regulations and guidelines applied in statistics the new ESA will not deviate from this definition.

Sub-sectoring of financial corporations according to monetary policy analysis purposes

Financial corporations

1. ***Monetary financial institutions***
    - *Central bank*
    - *Deposit-taking corporations*
    - *Money market funds (MMF)*
2. ***Miscellaneous financial corporations***
    - *Non-MMF investment funds*
    - *Other financial institutions*
        - *Other financial intermediaries*
        - *Financial auxiliaries*
        - *Captive financial institutions and money lenders*
3. ***Insurance corporations and pension funds***
    - *Insurance corporations*
    - *Pension funds*

A second type of sub-sectoring, which is consistent with the first one, can be chosen to clearly define financial intermediation. Financial intermediation is carried out by the majority of financial corporations, e.g., central bank, deposit-taking corporations, investment funds (MMF and non-MMF), ICPFs, and other financial intermediaries, while no financial intermediation is provided by financial auxiliaries and captive financial institutions and money lenders.

[1] For households, three different methods of sub-sectoring are proposed: sub-sectoring according to income, to characteristics of a reference person and to household size and location (see draft chapter 4, paragraphs 153 to 158); for general government two methods of sub-sectoring are described depending on how to integrate social security funds.

b. Holding companies

In paragraphs 4.46 and 4.47 two types of holding companies (we would recommend to speak of holdings) are distinguished: (a) head offices and (b) holdings without any management activities. It is recommended to classify head offices either as non-financial corporations or as financial auxiliaries (in cases where all or most of their subsidiaries are financial corporations). Holdings without any management activities may always be allocated to the financial corporations sector.

A head office should be classified according to the activities of its subsidiaries – either as a non-financial corporation or as a financial corporation. As a financial corporation it should in principle be classified as an '*other financial intermediary'* and not as a financial auxiliary (as recommended in paragraph 4.46) or as a captive financial institution (as recommended in paragraph 4.106). Accordingly, the list of other financial intermediaries, except ICPFs, in paragraph 4.102 should be amended. If, however, a head office which is a financial corporation is also active as an insurance company it should be classified as an 'insurance corporation'. Holdings without management activities do not provide a service to the businesses in which the equity is held, i.e. they do not administer or manage other units. Accordingly, the AEG recommendation on holding corporations should be followed by classifying them as captive financial institutions which is consistent with the new ISIC. Paragraph 4.106 mentions this type of a financial holding corporation (classified as a captive financial institution).

c. Institutional units with no employees and little production activity

Financial holdings, but also special purpose entities (SPEs) or special purpose vehicles (SPVs) with no employees and little production activity (like brass plates) are seen as institutional units classified as captive financial institutions (paragraphs 4.105 and 4.106). Paragraph 4.52 lists examples of subsidiary corporations (providing services to the parent corporation) which should not be treated as separate institutional units.

Concerning the paragraphs 4.48 to 4.54 the statistical treatment of securitisation through financial vehicle corporations (FVCs) is of particular analytical interest for the ECB. Securitisation is developing fast and with a significant degree of complexity, which is interfering with the consistency of various statistics. In some cases, the analysis of the growth in credit extended by credit institutions is hampered and monetary aggregates and minimum reserves may be affected. The main focus is on FVCs where not all the risks and rewards are transferred to the FVCs and, hence, under IFRS the loans must still be recorded on the books of the originating monetary financial intermediary. Further discussion on these topics might be useful and it is assumed that the new SNA can be drafted in a consistent and coherent way.

The wording needs also to allow for full consistency with the BPM6, and to make clearer the frontier between institutional units and "artificial units". The latter are not mentioned in the BPM6, so that the articulation between the two Manuals needs to be explained in more detail.

d. Further details on insurance corporations and pension funds

It would be useful to further subdivide insurance corporations and pension funds. Like for the other sub-sectors a list of entities (activities) could be shown belonging to the two sub-sectors. Insurance should be split into non-life insurance, life insurance and reinsurance. Non-life insurance covers fire; liability;

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[2] See paragraph 4.123 of the draft BPM.

motor insurance; marine, aviation and transport; accident and health; and financial insurance; life insurance covers: life assurance, and annuities insurance; reinsurance cover may be proportional or non-proportional.

For pension funds reference could be made to the classification as outlined in draft chapter 17 (pension funds as defined contribution schemes or as defined benefit schemes – both groups of units classified within the financial corporations sector).

3. Other issues

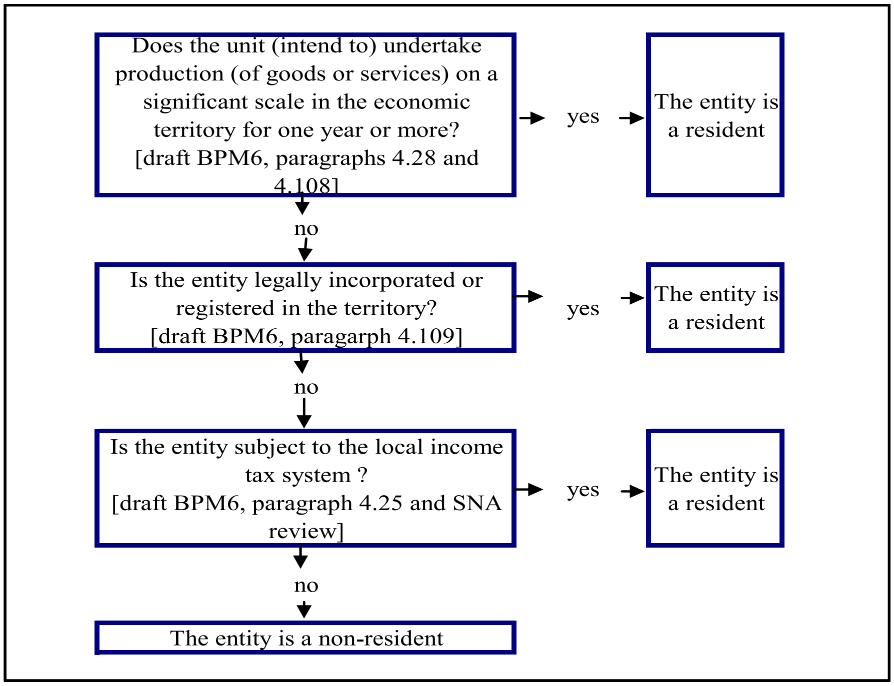
a. Residence

The concept of residence is shortly described in the paragraphs 4.10 to 4.12. We welcome the fact that "the concept of residence is exactly the same as in BPM6" and that further elaboration of borderline cases is given in chapter 24 and in BPM6. In drafting, we suggest to explicitly refer to paragraphs 4.119 to 4.132 of the BPM6.

In addition, it would be important to explicitly mention in the SNA at least the most important points, especially the statement of the BPM6 in paragraph 4.123. Because of its significance in terms of statistical legislation it would be useful to mention these borderline cases also in this SNA chapter – especially the cases where "*in the absence of any significant physical dimension to an enterprise, its residence is determined according to the economic territory under whose laws the enterprise is incorporated or registered. If there is no incorporation or registration, legal domicile is used as a criterion, that is, the jurisdiction of the laws that govern the creation and continued existence of the entity. The incorporation and registration represents a substantial degree of connection to the economy, associated with jurisdiction over the enterprise's existence and operations. In contrast, other connections such as ownership, location of assets, or location of managers or administration may be less clear-cut.*"[2] This may be relevant to investment funds (as distinct from their managers), securitisation vehicles, or some special purpose entities.

Furthermore, it would be useful to refer to a decision tree which deals with the issue how to assess of whether an institutional unit is a resident unit or a non-resident unit. The decision tree could be shown separately or also be easily integrated into Figure 4.1 which deals with the allocation of units to institutional sectors.

Assessment of whether an institutional unit is a resident unit or a non-resident unit



b. Classification of general government

The paragraphs 4.111 to 4.141 deal with the general government sector and its sub-sectors. Two proposals are made on the sub-sectoring: For the first proposal, four sub-sectors are distinguished which are, if applicable, central government, state government, local government, and social security funds. The second proposal distinguishes only between central government, state government and local government while the corresponding social security funds are included appropriately. At the end, this approach for the sub-sectoring is followed and is also seen as the approach generally favoured in the GFSM 2001.

Please be aware that government finance statistics and government sector accounts in the EU will continue to follow the former sub-sectoring. ESA95 specifies four sub-sectors of the general government. This is clearly preferable because of the importance of social security in Europe. Furthermore, many transfers between central, state and local governments and social security funds take place which should be shown in the accounts because of their importance for fiscal policy analysis.

Finally, the specific focus on insurance, pension and social security pension funds in the new SNA (as outlined in draft chapter 17) suggests a separate specification of the social security funds sub-sector and a further subdivision into a pension and non-pension related part.

c. The rest of the world and international organisations

The rest of the world sector is described in paragraph 4.33 and – more detailed - in paragraphs 4.162 to 4.164. As mentioned in the text the rest of the world is seen as the sixth sector – especially in terms of horizontal balancing between total sources and uses, changes of assets and liabilities as well as assets and liabilities by type of transaction and position. In practice, however, it is obviously not a sector strictu sensu, as it isn't a collection of units.

It may be helpful to mention the threshold for FDI earlier, in the section on control (4.58) – elaboration can come later (as now).

Concerning the section on international organisations (paragraphs 4.163 and 4.164) it might be necessary to also mention the existence of supranational organisations in the case of monetary or economic unions, like in Europe. For the countries which are members of such unions, any supranational organisation(s) may have been entrusted and it is important to further split their rest of the world accounts into the corresponding supranational organisation(s), the other member countries of the respective union and third countries and international organisations. Generally speaking, account should be taken – somewhere in the new SNA – of the fact that monetary or economic unions exist worldwide with a common organisation structure different from usual structures of international organisations.

d. Households

Nowhere is the treatment of housing services arising from owner occupation mentioned. Please mention it in 4.17, and describe it in section G2.

Part II: Comments on specific draft paragraphs or passages

In your review of draft chapter 4, you may wish to devote particular attention to the passage listed below. For ease of reference, we have identified the relevant paragraphs. Please use the space provided to the right of the paragraph number to make your comment.

1. Section A, paragraphs 4.10 – 4.12:

   The definition of 'residence' was slightly changed in the 1993 SNA Rev.1 by introducing 'predominant' before "economic interest." Because residence is principally a BOP term, the text in paragraphs 4.10 – 4.12 has been taken from *BPM 6*. Do you consider the definition appropriately described? Is it clear to a national accountant?

4.11 See above.

2. Section A, paragraph 4.20:

   A decision tree allocating units to institutional sectors and sub-sectors has been added as figure 4.1. It is first referred to in paragraph 4.21 to the 1993 SNA Rev.1. Do you think it is useful? YES.

4.21 See above.

3. Section B, paragraphs 4.52 – 4.54:

   The expression 'ancillary corporation' in the 1993 SNA did not fit neatly with the discussion on ancillary activities discussed in draft chapter 5 of the 1993 SNA Rev.1. Therefore the term 'artificial subsidiary' has been introduced. Do you agree with this new terminology? YES.

4.53 But what if the artificial unit is non-resident (from the national perspective) – is it a separate institutional unit in that case? Implications for the b.o.p./i.i.p. if it is; and for regional (e.g. monetary union) aggregates if it is not?

The text should be consistent with paragraph 4.17 of the current draft of the BPM6 which reads as follows: "An ancillary corporation is recognized as a separate institutional unit when it is resident in a different economy from that of any of its owners, even if the ancillary corporation is not, in practice, autonomous."

4. Section B, paragraphs 4.64 – 4.72 and section C, paragraphs 4.82 – 4.83

   Material from draft chapter 21 (public sector) of the 1993 SNA Rev.1 on control of corporations and of NPIs by government has been brought together. Do you consider this useful?

4.69 The term "public sector", which occurs several times in 4.69 (and occasionally elsewhere), is confusing. See above.

5. Section D, paragraphs 4.89 – 4.90:

   NPIs are distinguished as a sub-sector of the non-financial corporate sector in the 1993 SNA Rev. 1. Other units in the sector have been labelled 'For Profit Institutions' (FPIs). Do you agree with the new terminology introduced in paragraph 4.89?

   Do you agree with the full sub-sectoring introduced in paragraph 4.90 and shown in table 4.1?

4.89 See above.
4.90 See above.

6. Section E, paragraph 4.94:

   The new sub-sectoring of the financial corporations sector, including again by NPIs and FPIs, has been introduced in paragraph 4.94. Do you agree with the new classification?

4.94 Yes, subject to comments above. In Table 4.2, point 8, "corporations" rather than "companies".

7. Section F, paragraphs 4.118 – 4.119:

   Do you consider the clarification of the role of social security funds in paragraphs 4.118 – 4.119 consistent with the GFSM? Paragraphs 4.118-4.119 set out the role of social security funds while trying to stay in line with text in the *GFSM* and draft chapter 21 of the 1993 SNA, Rev. 1. Is the text appropriate and clear?

4.118 See above.

Part III. Other specific comments

You are welcome to make other comments. Please do so by using Adobe Acrobat Version 6 or 7 to comment directly on the PDF of the draft chapter.

If you don't have Adobe Acrobat Version 6 or 7 and would like to make detailed comments, please send a message to sna@un.org requesting a version of the draft chapter that permits you to comment. To optimize your commenting tools, please download Adobe Reader 7.0 for free from http://www.adobe.com/products/acrobat/readstep2.html

THE ADDITIONAL POINTS WHICH FOLLOW DO NOT REPEAT THE ABOVE.

4.2 (d) [Comment also made on BPM6]: "it would be possible and meaningful, from both an economic and legal point of view." We have noted that this text is derived from the 1993 SNA, Rev.1, paragraph 4.2. However, in the case of branches, having separate accounts may not be meaningful from a legal point of view. Would it not be sufficient to refer to "it would be (i) possible and (ii) meaningful from an economic point of view"?

	It is also not fully clear from the drafting if all criteria, or only most of them, should be met to have an institutional unit. This room for interpretation will lead to inconsistencies.
4.4	Why not distinguish between “individual households” and “institutional households?” Paragraph 4.75 distinguishes between ‘individual households’ and ‘groups of households.’
4.14	Should read "according to the nature of the *main* economic activity they undertake …" … allocated to sector<u>s</u> …
4.19	At this stage, only four institutional sectors have been distinguished. Therefore, it is necessary to introduce earlier the split between non-financial and financial corporations.
4.24	First sentence is quite obvious. Why not start with the second part: “While non-financial corporations make up most of the sector it includes also …”
4.25	The description of financial corporations looks different from that of paragraph 4.92. In 4.25, other financial institutions are not mentioned, but apparently replaced by a reference to NPI. If they are the same, it may be useful to explain. But it may be the best to use the same wording in both paragraphs and cross-reference them.
4.34	The definition of corporation is in line with paragraph 4.23. It seems that it is also compatible with paragraph 4.7 which includes "quasi-corporations", presumably defined according to the criteria of 4.34?
4.36 (f)	Full stop at the end.
4.38	This paragraph should come after paragraph 4.43.
4.42	Second sentence: Equity instead of capital.
4.46	Something more on groups (especially in the context of international accounting standards and macro-prudential indicators). See also 4.61.
4.64 to 4.70	These paragraphs should be shown in chapter 21. See also above.
4.71	Whereas paragraph 4.71 of the revised SNA quotes “*A non-resident controls unit a resident corporation if the non-resident unit owns more than 50% of the equity of the corporation”* the new definition of control in BPM6 (paragraph 6.6) is the following: “*control means that the direct investor holds more than 50 per cent of the voting power in the direct investment enterprise.”* In substance, the new BPM6 recognises that voting power can be exercised without a commensurate ownership of shares (like for unincorporated entities, for which there are no tradable shares). Voting power may also be larger or smaller than the percentage of shares if there are golden shares or dual classes of shares, and can be indirectly obtained through chains or an intermediate entity controlling the enterprise.
4.78	We would omit the last sentence: such NPIs may well be charities, and the quality of their service, and the possibility that they use endowment income to subsidise the educational, health etc services that they provide, are not relevant to their statistical classification.
4.72	… held by non-resident<u>s</u> …
4.79	Strictly speaking, the activities described are of common, not mutual, benefit to the businesses that finance them.
Table 4.1	A decision tree would be better than this table.
4.91/ 4.92	It is stated that financial corporations produce financial services. Paragraph 4.92 states that in particular other financial corporations provide financial services. However, most holdings will have no production at all (not even FISIM).
4.91	Suggest a cross-reference to 4.109 (which gives instances of non-financial

corporations providing financial services).

These definitions should be made clearer (in line with ESA 95, paragraphs 2.32 to 2.34).

4.92 8-9th lines: Suggest "Financial auxiliaries are institutional units….."

Table 4.2 [Comment similar to that made on BPM6] (terminology) The term "other financial intermediaries, except ICPFs" may be difficult to understand for users, and to use in economic analysis. It might have been clearer to distinguish central banks, monetary financial intermediaries, money market funds, non-MMFs investment funds, insurance corporations and pension funds, "non-monetary financial intermediaries excluding investment funds, insurance corporations and pension funds [which could then be summarised as "other financial intermediaries")", financial auxiliaries and "captive financial institutions and money lenders".

Sub-sector 4. Prefer, "Investment funds, other than MMF".

Sub-sector 7. Prefer, "Other financial institutions, except ICPFs"

Sub-sector 8: Insurance corporations instead of insurance companies.

4.97 The definition of deposit-taking corporations should be exactly the same as that of BPM6 (para 4.66). Currently, it refers (in a loose wording, which does not make it clear if this is a condition) to entities having deposits or close substitutes as liabilities, while the BPM6 refers to having liabilities included in the national definition of broad money. The latter point is added as a usual feature in paragraph 4.97, but not as a condition for an entity to be in this sub-sector.

Suggest "To this end, they have, or are authorized to incur, liabilities…", the point being that a licence to take deposits etc should determine the classification of the institution, whether or not in practice it has liabilities in these forms. I would also omit "short-term".

4.98 (f) Same as the first point on 4.97.

4.99 Suggest "MMF shares may be, but need not be, be transferable by cheque…"

The definition of MMFs should also refer to debt instruments with a residual maturity of exactly one year in order to make it consistent with existing ESCB legislation (Regulation ECB/2001/13). More specifically, the phrase "residual maturity of less than one year" should be replaced by "residual maturity of up to and including one year".

4.100 Last sentence: The definition of investment funds must be the same as in the BPM6, which includes a reference to "the sole objective" of investing capital raised from the public.

To read, ""They are not transferable by means of cheque or other means of direct third-party payment".

4.101 Delete "open".

4.102 c) Redraft as "Financial corporations engaged in lending, including for retailers who may be responsible for financial leasing and for both personal and commercial finance."

4.102 (f)

"…including the finance associates…"

4.104 (j)	Credit insurance corporations and guarantee banks are classified as financial auxiliaries if they do not have differentiated pools of reserves to meet claims. It is not clear to us which types of institutions are meant. According to our experience, all credit insurance corporations and guarantee banks should be classified as insurance corporations.
4.105	The definition of "other financial institutions, except ICPFs" would imply to include in this sub-sector all entities working only for their group, e.g. the bank or treasury centre of a multi-national group, while they may otherwise play the same economic and financial role as financial intermediaries.
4.106	Full stop, after pawnshops indent.
4.107/ 4.108	Should replicate current 4.97 and 4.98, respectively of SNA 93
4.108	"…of employees of other entities (or of their own employees)…"
4.109	The example of secondary financial activities is not really financial innovation. 4.109 and 4.110 belong either in a Guide or within the NFC section.
4.111 (b), (i)	Please delete "as a result of market failure". These are public goods the provision of which no-one would expect markets to organize and finance. We wouldn't call that a market failure. We would make the same point on 4.113, 8th line.
4.113	The reference to "market failure" is surprising in such a Manual, as suggesting a judgement from the authors on how the economy should work. This is not necessary.
4.117	Suggest "the government sector to be a market producer."
4.118	Schemes or funds?
4.120 (a)	We would prefer to show four sub-sectors as discussed above.
4.132	Suggest "and not in the financial corporations sector."
4.135	Suggest "as an institutional unit a state government must…"
4.136 (a)	"A corporation will normally be expected…" Are there exceptions to this rule? If not, better omit "normally".
4.139	Suggest "treated as quasi-corporations in the non-financial corporations sector ..."
4.163 (a)	Suggest "The members of an international organisation are national states, other national bodies, or other international organizations…", the point being that the members of a regional central bank (d) (ii) are NCBs, not governments.
4.164	Suggest "are treated in national statistics as…"