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**Classification and terminology of financial corporations in the updated SNA**

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## CLASSIFICATION AND TERMINOLOGY OF FINANCIAL CORPORATIONS IN THE UPDATED SNA<sup>1</sup>

### *Executive Summary*

*The review of the 1993 SNA has already touched on some issues concerning the classification of and terminology relating to financial corporations. Examples are the retained earnings of mutual funds, insurance corporations and pension funds, and the treatment of holding companies, SPVs, mutual funds, etc.. This note starts with an outline of the current classification and terminology used for financial corporations in the 1993 SNA and in the 1995 ESA in Section 2. It outlines the reasons for modifying the current classification and terminology in Section 3. The decisions taken and observations made so far by the AEG are described in Section 4. Various recommendations related to the classification of financial corporations and to the corresponding terminology are made in Section 5. It also proposes showing some key items in boxes in the updated SNA. The main recommendations are to*

- 1. Classify financial corporations into the five subsectors monetary financial intermediaries, investment funds, insurance corporations and pension funds<sup>2</sup>, miscellaneous financial intermediaries, and financial auxiliaries; and to*
- 2. Present the terms financial corporations and financial intermediation and monetary financial intermediaries in boxes in the new SNA.*

*Do you agree with the analysis of the current standards as presented in Section 2 and of the reasons for changes of the 1993 SNA as outlined in Section 3 as well as with the proposed recommended solutions as described in Section 5?*

### **1 Introduction**

1. One of the cross-cutting items indirectly touched by the various 1993 SNA update and clarification issues refers to the classification and terminology relating to financial corporations. These issues are the treatment of retained earnings of mutual funds, insurance corporations and pension funds as institutional units (issue 42)<sup>3</sup> and of holding companies, special purpose entities (SPEs), trusts or special purpose

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<sup>1</sup> The views expressed in this paper are those of the author and do not necessarily represent those of the European Central Bank.

<sup>2</sup> In addition, splitting up pension funds and insurance corporations could enable a richer analysis of different types of collective investment schemes.

<sup>3</sup> In the 1993 SNA retained earnings of an entity are generally treated as the income and saving of the entity, rather than the owner. However, exceptions are made for life insurance companies, pension funds and foreign direct investment companies, where there is an imputed flow to the policyholders, beneficiaries, and owners, with an equal financial account flow. The ESA 95 introduces an imputed transaction for the retained earnings of the mutual funds where income is attributed to the investors and then reinvested in the fund. That treatment brings about some consistency with the treatment of life insurance and pension funds which are other types of collective investment schemes.

vehicles (SPVs) (issue 25).<sup>4</sup> Other issues are how to delineate private and public financial corporations (issue 36) or how to define financial intermediation and financial intermediaries (issue 6).<sup>5</sup> Papers on these issues were prepared by the Balance of Payments Committee (BOPCOM), the Task Force on Harmonisation of Public Sector Accounting (TFHPSA), and the OECD Task Force on Financial Services and forwarded to the Advisory Expert Group (AEG) meetings in December 2004 and in July 2005. One clarification issue on the review of SNA terminology for user-friendliness (C3) is somewhat linked to this subject.<sup>6</sup>

2. The note deals with this cross-cutting item in a rather broad context. First, it describes the current classification and terminology used for financial corporations in the 1993 SNA (and also in the 1995 ESA) (Section 2). Second, it outlines the case for modifying the current classification and terminology (Section 3). Third, the decisions taken and observations made so far by the AEG are described in Section 4. Fourth, various recommendations related to the classification of financial corporations and to the corresponding terminology are made in Section 5. It also covers proposals how to present information on key issues like financial intermediation and monetary financial intermediaries (MFIs) as boxes in the updated 1993 SNA.

## **2 Current classification and terminology of financial corporations in the 1993 SNA, the 1995 ESA and related manuals**

3. This section deals with the current classification and terminology of financial corporations in the 1993 SNA, the 1995 ESA, and to some extent the 2000 IMF Monetary and Financial Statistics Manual. In this context, it describes the definition of financial corporations, discusses the concept of financial intermediation and, based on this, outlines the current classification and terminology used for financial corporations.

### ***2.1 Financial corporations and financial intermediation as defined in the 1993 SNA and in the 1995 ESA***

4. The definition of financial corporations in the 1993 SNA is closely linked to the economic activities of these institutional units in the form of financial intermediation and of related auxiliary financial activities: *“The financial corporations sector consists of all resident corporations or quasi-corporations principally engaged in financial intermediation or in auxiliary financial activities which are closely related to financial intermediation”* (see 1993 SNA, paragraph 4.77). Financial intermediation is, in turn, defined as *“a productive activity in which an institutional unit incurs liabilities on its own account for the purpose of acquiring financial assets by engaging in financial transactions on the market”*. Moreover, the 1993 SNA

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<sup>4</sup> In financial markets and asset management, separate entities have come into existence that only hold assets or liabilities but do not enter into production. Such entities use legal structures or/and are set-up for specific purposes such as ad-hoc structures specialized in managing portfolios of assets and debts, restructuring agencies, special purpose entities, shell companies, limited liability partnerships or trusts. For these entities, principles have to be formulated whether to treat them as separate institutional units or not (issue 25).

<sup>5</sup> The issue ‘financial services’ (issue 6) is devoted to the measurement of output of financial intermediation services and portfolio management in the national accounts. The business of financial corporations has undergone a structural transformation towards a rising importance of the portfolio management of financial assets. This generates holding gains and losses, that, typically, national accounts exclude from the production boundary and therefore income. The review considers whether and how the production boundary can be adapted to this rising activity, and how this could influence income.

<sup>6</sup> The present SNA terminology makes extensive use of the word ‘other’ of rather complex and comprehensive terms. Examples are for institutional sectors: other financial intermediaries except insurance corporations and pension funds. This makes it difficult for economists and analysts to use the exact terminology.

describes the role of financial intermediaries as institutional units, which “collect funds from lenders and transform, or repackage, them in ways which suit the requirements of borrowers”. Finally, the 1993 SNA mentions that “a financial intermediary does not simply act as an agent for other institutional units but places itself at risk by incurring liabilities on its own account” (see 1993 SNA, paragraph 4.78).

5. The 1995 ESA provides some further clarification. It specifies that “funds are transformed or repackaged with respect to maturity, scale, risk and the like in the financial intermediation process” (see 1995 ESA, paragraph 2.32). The fact that the scope of financial intermediation is limited to “financial transactions in the market” implies that acquiring assets and/or incurring liabilities on behalf of one individual, family, or other institutional unit or group of closely related units should be excluded.<sup>7</sup> Also excluded would be the use of an institution’s own funds only to finance a portfolio of assets. The 1995 ESA further clarifies the categories of assets and liabilities which may be involved in financial intermediation, and covers also an important category of financial intermediaries, which are mutual funds.

## 2.2 The classification scheme used in the 1993 SNA and in the 1995 ESA

6. The current classification of financial corporations in the 1993 SNA and in the 1995 ESA distinguishes five subsectors (see Table 1).

**Table 1: Classification of financial corporations by subsector in the 1993 SNA and in the 1995 ESA**

Current SNA classification		Deviations of the ESA classification from the current SNA classification	
Financial corporation	SNA code	Financial corporation	ESA code
<b>The central bank</b>	<b>S.121</b>		
<b>Other depository corporations</b> Deposit money corporations Other	<b>S.122</b> S.1221 S.1222	<b>Other monetary financial institutions<sup>1</sup></b>	<b>S.122</b>
<b>Other financial intermediaries except insurance corporations and pension funds</b>	<b>S.123</b>		
<b>Financial auxiliaries</b>	<b>S.124</b>		
<b>Insurance corporations and pension funds</b>	<b>S.125</b>		

<sup>1</sup> The monetary financial institutions (MFIs) comprise the subsectors central bank (S.121) and other monetary financial institutions (S.122), and coincide with the monetary financial institutions for statistical purposes as defined by the ECB (originally the EMI) (see paragraph 2.41 of the 1995 ESA).

7. These are the central bank, other depository corporations (or other monetary financial institutions in the 1995 ESA), other financial intermediaries except insurance corporations and pension funds, financial auxiliaries, and insurance corporations and pension funds.

8. One difference between the two schemes refers to the subsector ‘other depository corporations’ in the 1993 SNA, which is called ‘other monetary financial institutions’ in the ESA 1995. Both standards define the sub-sector as consisting of all resident financial corporations and quasi-corporations principally engaged in financial intermediation and having liabilities in the form of deposits or financial instruments such as short-term certificates of deposit which are close substitutes for deposits in mobilising financial resources and which are included in measures of money broadly defined (paragraph 4.88). In the 1995

<sup>7</sup> There may be borderline cases of collective investment schemes with a somewhat limited range of clients.

ESA, these institutions also grant loans and/or make investments in securities (paragraph 2.48). Institutions not issuing liabilities included in national definitions of broad money would, therefore, not be classified as other depository corporations.<sup>8</sup>

9. The current SNA provides a further breakdown of the subsector which is not in the 1995 ESA, namely (where relevant) the sub-set of depository corporations whose deposits contribute to money in the narrow sense. This sub-set is described as “deposit money corporations” (S.1221). The second sub-set “other” (S.1222) consists of depository corporations which do not have such liabilities. The 1993 SNA however underlines the difficulty of drawing a clear distinction between narrow and broad money, and recognises that the distinction between “deposit money corporations” and “other” depository corporations may be too blurred to be operational in some countries (paragraph 4.94).

10. The 1995 ESA is more explicit on which institutional units should be classified within the subsector S.122 and which, together with the central bank (S.121), form the set of money creating institutions in ECB statistics (in practice deposit liabilities of some government units are added in) (paragraphs 2.50 and 2.51).

11. The financial corporations classified in the subsector ‘**other financial intermediaries except insurance corporations and pension funds**’ (S.123) are only briefly described in the 1993 SNA as financial intermediaries which raise funds on financial markets, but not in the form of deposits, and use them to acquire other kinds of financial assets. The types of corporations which may be included under this heading are those engaged in financing capital formation, for example, investment corporations and corporations engaged in financial leasing, and hire purchase corporations and other corporations engaged in the provision of personal finance or consumer credit (see paragraph 4.95).

12. The 1995 ESA determines which types of financial corporations should be classified under this subsector. These are, among others, corporations engaged in financial leasing, in hire purchase and the provision of personal and commercial finance, and in factoring, security and derivative dealers, specialised financial corporations, financial vehicle corporations, or financial holding corporations (see paragraph 2.55). The IMF MFSM also provides detailed examples of units that are classified as other financial intermediaries such as finance corporations, financial leasing companies, investment pools, securities underwriters and dealers, vehicle companies, financial derivative intermediaries and specialised intermediaries (see paragraph 100).

13. In the current SNA “*holding corporations are classified as financial if the preponderant type of activity of the group of corporations as a whole is financial... and allocated to sub-sectors according to the type of financial activity mainly carried out by the group it controls*” (see 1993 SNA, paragraph 4.100). The 1995 ESA deviates from this recommendation in classifying all financial holding companies in the sub-sector other financial intermediaries except insurance corporations and pension funds (S.123) (paragraph 2.43).<sup>9</sup>

14. According to the 1993 SNA **insurance corporations** consist of incorporated, mutual and other entities whose principal function is to provide life, accident, sickness, fire or other forms of insurance to individual institutional units or groups of units. **Pension funds** are established for purposes of providing benefits on retirement for specific groups of employees (see paragraphs 4.97 and 4.98). The 1995 ESA is slightly more detailed in describing which institutional units should be and which should not be classified within

<sup>8</sup> See also the IMF’s Monetary and Financial Statistics Manual 2000 (MFSM), paragraph 93.

<sup>9</sup> The classification of holding corporations within the financial corporations sector deviates from the 1993 SNA, paragraph 4.100 in order to maintain consistency with the monetary financial institutions for statistical purposes as defined by the EMI and with official statistics on insurance corporations.

this subsector.<sup>10</sup> It also proposes a further subdivision of the subsector into (a) insurance corporations; and (b) (autonomous) pension funds (see paragraphs 2.60 to 2.67).

15. **Financial auxiliaries** are primarily engaged in activities closely related to financial intermediation but do not themselves perform an intermediation role. The 1993 SNA lists corporations such as securities brokers, loan brokers, flotation corporations, and insurance brokers. They also include corporations whose principal function is to guarantee, by endorsement, bills or similar instruments intended for discounting or refinancing by financial corporations, and also corporations which arrange hedging instruments which are continually being developed as a result of wide-ranging financial innovation (see paragraph 4.96). The 1995 ESA mentions also for classification as financial auxiliaries corporations providing infrastructure for financial markets or central supervisory authorities, managers of pension funds, mutual funds, etc. or corporations providing stock exchange and insurance exchange (see paragraph 2.58).

### 3 Reasons for changes of the classification in the 1993 SNA

16. There are various reasons to modify the classification and the terminology relating to financial corporations in the 1993 SNA. First, the more detailed descriptions of financial corporations in the 1995 ESA and in the 2000 MFSM may improve the current presentation in the 1993 SNA. Recent legislative work and developments on the financial markets should also be taken into account for the SNA update. Finally, policy and analytical needs in the context of monetary and financial stability analysis are also of some importance on how to define and classify financial corporations; more information about financial corporations has become available in recent years, and – partly because of growing interest in financial stability issues – policymakers are seeking more institutional detail on the financial corporations sector. As highlighted in the draft report of the OECD Task Force on Financial Intermediation “financial innovation ... encourages ‘traditional’ financial corporations to set up specialised institutions or to outsource the management of such instruments.” The new SNA should accommodate that process and satisfy developing policy-related needs.

### 4 Progress achieved so far

#### 4.1 Progress in the context of the SNA review

17. Some progress has already been made within the SNA review to clarify various sub-issues of item 25 on the treatment of units. Topics included in sub-item 25b were discussed during the second and third meeting of the AEG in December 2004 and in July 2005. Decisions and observations were made on the treatment of unincorporated entities and branches, of SPEs, and of SPVs established by general government.<sup>11</sup>

18. For **unincorporated entities and branches** a relatively clear set of rules has been agreed, even though with some flexibility. In line with the BOPCOM’s proposals, the AEG stated that “*physical presence is not required for a branch to be recognized. Being subject to income tax laws should replace paying income tax as an indicator of the existence of a branch. All criteria should be considered as indicators for*

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<sup>10</sup> In both manuals, insurance is described in separate annexes. See Annex IV of the 1993 SNA and Annex III of the 1995 ESA.

<sup>11</sup> In addition to the decisions on unincorporated entities and SPEs, the AEG discussed the treatment of multi-territory enterprises, and proposed to extend it in the BPM5 “to all kinds of activities, when formal separation is not possible. Units operating in zones of joint sovereignty or jurisdiction should be split between these in ways that still need to be specified. The broader question of multinational enterprises should be addressed by a task force, taking account of IASB recommendations and work in hand for the next 2005 ISI meeting in Sydney.”

*a separate branch but not all criteria have to be met. Even if the entity does not have a full set of accounts, if it engages in production, it should be treated as a branch.”*

19. This decision of the AEG in December 2004 was based on a paper prepared by the BOPCOM's BOPTTEG,<sup>12</sup> which proposed the following criteria to treat an unincorporated entity/branch as an institutional unit. It should (i) engage in significant production of goods and services; (ii) plan to operate the business indefinitely or for a long period of time; (iii) have a substantial physical presence; (iv) maintain a complete and separate set of accounts for the local activities (i.e., income statement, balance sheet, transactions with the parent enterprise); (v) pay (corporate) income taxes to the host country (criterion mentioned in paragraph 78 of the BPM5, but not in the 1993 SNA); and (vi) receive funds for enterprise work for the enterprise account (criterion mentioned in paragraph 78 of the BPM5, but not in the 1993 SNA).

20. The BOPTTEG discussed these criteria and supported the view that all of them should be considered. However, not all of them should necessarily be met. In particular, criterion (iii) on the physical presence was not seen as a necessary condition for an institutional unit. As indicated in the AEG decision the criterion “paying income tax” was modified to “being subject to income tax laws.”

21. In its December 2004 meeting, the AEG did not provide a specific definition for **SPEs**. Moreover, the AEG asked for “some indicative guidelines on the identification of SPEs across manuals, although an internationally accepted standard definition of SPE is not available in light of the national diversity.” Detailed criteria such as those proposed for unincorporated entities are not available as yet in respect of SPEs, although the European System of Central Banks (ESCB) has agreed upon a standard definition of SPEs as part of the delineation of the other financial intermediaries except insurance corporations and pension funds subsector. Furthermore, the AEG has concluded that “an SPE incorporated in an economic territory other than any of its owners should be treated as a separate institutional unit and resident in its country of incorporation.”

22. On the classification of **non-resident SPVs established by general government**, the AEG expressed concern that consistency problems with the BPM5 could arise from the recommendation by the TFHPSA that these non-resident units be treated as part of general government.

#### **4.2 Progress made on other financial intermediaries statistics**

23. In the context of the work undertaken to develop statistics for other financial intermediaries except insurance corporations and pension funds (OFI), the ESCB has defined five types of institutions in this sub-sector (S.123) in the European Union.<sup>13</sup> They are: (i) investment funds (IFs)<sup>14</sup>; (ii) financial vehicle corporations (FVCs) created to hold securitised assets<sup>15</sup>; (iii) financial corporations engaged in lending (FCLs); (iv) financial holding corporations (FHCs); and (v) security and derivative dealers (SDDs). The institutional units of the OFI sub-sector not covered by the five groupings are allocated in a remaining grouping as “other”. The current working definitions are presented in Annex 1. Of course, only those entities fulfilling the criteria of an institutional unit would be considered in this framework.

<sup>12</sup> See R. Dippelsman, “Special purpose entities and holding companies”, Balance of Payments Technical Experts Group (BOPTTEG) paper 5, 2004.

<sup>13</sup> The decisions below therefore only refer to those units which would be treated as institutional units, rather than ancillaries.

<sup>14</sup> This grouping has been proposed to be treated as a sub-sector of S.123: see note, entitled “Retained earnings of mutual funds”, dated June 2005, prepared by Eurostat and the ECB/DGS.

<sup>15</sup> “Special Purpose Vehicles” (SPVs) are defined as equivalent to FVCs.

#### ***4.3 Progress based on the work of the ESA95 manual on government deficit and debt (MGDD)***

24. As outlined in the previous section, FVCs created to be holders of securitised assets may be seen as SPVs and should be classified as OFIs. This complies with the proposed treatment of such units in the MGDD. The manual defines the necessary conditions to be fulfilled to classify units securitising government assets as SPVs.<sup>16</sup> Thus the government assets to be sold to the SPV must exist in the government's balance sheet before the arrangement starts. To be treated as a "true sale" the SPV has to take over all risks of the assets.

25. Assuming that privatisation and restructuring agencies are separate institutional units and that they are not part of general government<sup>17</sup>, it seems appropriate to classify them according to the following considerations:

26. Privatisation agencies are usually holding corporations. Accordingly, their sector allocation follows the considerations underlying the classification of this type of institution. Furthermore, some additional guidance might be integrated into the new SNA regarding two specific cases, considered by the ESA95 manual on government deficit and debt: (i) units created in the course of a privatisation to hold shares of public corporations that the government wants to dispose of should be classified in the general government sector, because they manage assets on behalf of government, which can be considered the ultimate owner of the assets; and (ii) units keeping the privatisation proceeds should also be allocated to the government sector, unless they act as a private corporation.

27. Restructuring agencies may have a financial or a non-financial nature. In the case of bad banks (financial corporations), two situations may be distinguished: a) the agency takes over the assets and the liabilities of the institution in difficulty, which ceases to exist; and b) the agency manages the institution in difficulty without taking over its balance sheet. In the first case, the restructuring agency usually takes the institutional form of the institution in difficulties, mostly an 'other depository corporation' (or a commercial monetary financial intermediary in the terminology proposed in this paper). In the second case, as the agency takes the responsibility (risk) to manage the institution in difficulties, the unit should be classified as an OFI according to current standards, though whether it should not rather be considered as a financial auxiliary may also be subject to debate.

28. An exception to these general rules could also be considered by taking into account the case where such agencies are set up to free government from some activities. The above-mentioned rules regarding privatisation agencies should then be applied.

## **5 Proposed solutions**

29. Based on the reasons for changes and on the decisions taken and work done so far the following recommendations concerning the **classification and terminology** of financial corporations are proposed.

### ***5.1 Proposed changes in the classification and terminology of financial corporations***

30. The proposed changes in the classification of financial corporations aim to meet current and prospective needs. In particular they make clearer the monetary nature of some financial corporations, and the fact that some (or even many) institutions whose liabilities contribute to broad money may not take

<sup>16</sup> See ESA95 manual on government deficit and debt, section V.2.

<sup>17</sup> The delineation between general government and other sectors is being discussed under another item of the list accepted for review by the AEG, i.e. item 36 "Private/public/government sector delineation (sectorisation boundaries)"

deposits; put one important constituent of the present other financial intermediaries except insurance corporations and pension fund subsector, namely investment funds, into a new subsector; and by reordering emphasise the different role of financial auxiliaries. The terminological proposals aim at shorter titles, avoiding if possible “other” which raises the question “other than what?” and so requires some explanation. “Other financial intermediaries, except insurance corporations and pension funds” is particularly clumsy. The proposed classification is summarised in Table 3.

**Table 3: Proposed classification of financial corporations in the new SNA:**

<b>Financial corporation</b>	<b>Present code</b>	<b>Proposed code</b>
<b>Monetary financial intermediaries</b>	<b>S.121, S.122</b>	<b>S.121</b>
Central bank	S.121	S.1211
Commercial monetary financial intermediaries	S.122	S.1212
Of which: Money market funds	S.123*	S.1212.1
<b>Investment funds</b>	<b>S.123*</b>	<b>S.122</b>
<b>Insurance corporations and pension funds</b>	<b>S.125</b>	<b>S.123</b>
Insurance corporations		S.1231
Pension funds		S.1232
<b>Miscellaneous financial intermediaries</b>	<b>S.123*</b>	<b>S.124</b>
<b>Financial auxiliaries</b>	<b>S.124</b>	<b>S.125</b>

\*means part of a broader category

31. **Monetary financial intermediaries** are financial corporations (including quasi-corporations, e.g. branches of non-resident institutions and institutions operating as mutuals, notably many cash or money market funds) with at least some monetary liabilities, meaning liabilities that form part of broad money. The proposed classification makes it clear that central banks are monetary financial intermediaries. It is tempting to call the second category “commercial banks”, which goes well after “central banks”, but this is probably ruled out on the grounds that the term “bank” means different things in different countries. The term commercial monetary financial intermediaries describes them while avoiding the term “depository corporations” used in the present SNA, since many of them do not take deposits (e.g. money market funds). However, the term deposit money corporations may still be appropriate for institutions (other than the central bank and perhaps some governmental units) with liabilities included in narrow money, where countries want to make that distinction.

32. Splitting out **investment funds** reflects their importance (about 75% of total S.123 balance sheets in the euro area and important also in some other economies) and the ECB’s plans to collect harmonised statistical data on them by regulation. This aspect of the proposal may however reflect a European bias. An alternative would be to have them as an optional category in S.123 (as presently numbered). “Investment funds” is wider than mutual funds, since it includes closed-end investment companies which issue equity. It would have to be made clear where cash or money market funds form part of the MFI subsector because their liabilities are part of broad money (S.122, or S.1212 in the new numbering). Within investment funds there may be interest in separate data for funds specialising in equities, bonds, and property, and perhaps for hedge funds. Listing all these (and perhaps other) types of institutions as separate sub-categories in the classification would risk overloading it; the proposal here would be to describe their features in the text of Chapter IV in order to promote clarity and consistency in the use of terms, and leave it to national compilers to collect separate data on them if they wish.

33. No further required breakdown is suggested for the remaining financial corporations in the present S.123. **Miscellaneous financial intermediaries** – which recalls the varied nature of this group, not only its residual nature - may describe them better than “other” financial intermediaries, though it would have to be abbreviated to MiscFIs to avoid confusion with monetary FIs. As a further supportive argument, a change

in the terminology (from OFIs to MiscFIs) would raise awareness on the different composition of both groups of entities, following the proposal to identify investment funds as a separate category.

34. Some of these categories comprise a mixture of institutions which some countries may wish to identify even if the breakdown is not required in the System. Miscellaneous financial intermediaries include (to name only a few types) FVCs set up to hold securitised assets (SPVs), financial corporations engaged in lending (consumer credit, trade finance, general business lending, financial leasing, housing finance), security and derivative dealers, financial holding companies, and venture capital companies - in all cases of course institutions which have no monetary liabilities. These and other miscellaneous financial intermediaries may be of considerable importance in some countries, and of much interest for policy analysis, but much less important if they exist at all elsewhere.

35. In some ways it would be natural to put the miscellaneous financial intermediaries subsector straight after investment funds and place insurance corporations and pension funds lower down. Since miscellaneous financial intermediaries are more like CMFIs and investment funds than insurance corporations and pension funds are, the ordering would be more coherent in terms of the characteristics of the institutions. However, that ordering has the disadvantage that a specific group of financial intermediaries follows the residual category – hence the proposed ordering.

36. It seems to be clearly best though to place **financial auxiliaries** after insurance corporations and pension funds because they are not financial intermediaries. It is recognised that many financial corporations provide both financial intermediation and financial auxiliary services. The proposal is that such corporations should be classified in the appropriate financial intermediary category unless financial intermediation is incidental to their main business of providing financial auxiliary services.

#### ***5.2 Financial corporations and financial intermediation, monetary financial intermediaries and special purpose entities described in boxes of the new SNA***

37. It is proposed to describe the terms financial corporations and financial intermediation, and monetary financial intermediaries in boxes in the new SNA. A first attempt at the content of these boxes follows.

***Financial corporations and financial intermediation***

The SNA distinguishes between financial and non-financial corporations. **Financial corporations** offer financial services, whereas non-financial corporations are essentially entities producing goods and non-financial services. Financial corporations act as (a) financial intermediaries by offering their liabilities as borrowers or their financial assets as lenders to institutional units in the non-financial sectors and /or to other financial corporations, or as (b) financial auxiliaries. Given the broad range of financial services, the financial corporations sector may be further divided into five sub-sectors according to the characteristics of their financial services, namely monetary financial intermediaries, investment funds, insurance corporations and pension funds, miscellaneous financial intermediaries, and financial auxiliaries. Some of these subsectors are subdivided in the SNA, and further distinctions may be made to meet national circumstances.

**Financial intermediation** is a productive activity in which an institutional unit incurs liabilities on its own account for the purpose of acquiring financial assets by engaging in financial transactions on the market. Financial intermediaries as institutional units collect funds from lenders and transform, or repackage them (with respect to maturity, scale, risk and the like) in ways which suit the requirements of borrowers.

Through financial intermediation, funds are channelled between third parties with a surplus on one side and those with a lack of funds on the other. A financial intermediary does not simply act as an agent for these other institutional units but places itself at risk by acquiring financial assets and incurring liabilities on its own account. (In some cases, for example some mutual funds, the risk may in practice be borne by the financial corporation which sponsors or manages them.) In the financial intermediation process, all categories of liabilities may be involved with the exception of the category other accounts payable. The financial assets involved in the financial intermediation process may be classified in any category with the exception of the category insurance technical reserves but including the category other accounts receivable (which factoring companies hold as assets). In addition, financial intermediaries may invest their funds in non-financial assets including real estate, though real estate corporations (NACE. rev.1 division 70) are not financial intermediaries because they do not transform funds.

The fact that the scope of financial intermediation is limited to “financial transactions in the market” implies that acquiring assets and/or incurring liabilities on behalf of one individual, family, corporation, or governmental unit, or a group of closely related units, is not regarded as financial intermediation. Institutions with this kind of business are classified to the institutional sector of the party for which they work.

***Monetary financial intermediaries***

The central bank and the commercial monetary financial intermediaries are called **monetary financial intermediaries**, since at least some of their liabilities contribute to monetary aggregates. The **central bank** (S.1211) consists of all financial corporations and quasi-corporations whose principal function is to issue banknotes (and sometimes coin), to maintain the internal and/or external value of the currency, and to hold all or part of the international reserves of the country. The following financial intermediaries are classified as the central bank: (a) the national central bank, including where it is part of a system of central banks; and (b) central monetary agencies of essentially public origin (e.g. agencies managing foreign exchange or issuing banknotes and coin) which keep a complete set of accounts and enjoy autonomy of decision in relation to central government. If such agencies do not enjoy autonomy of decision in relation to central government, they are classified as part of general government. S.1211 also does not include agencies and bodies, other than the central bank, which regulate or supervise financial corporations or financial markets. They are classified as financial auxiliaries.

**Commercial monetary financial intermediaries** (S.1212) consists of all financial corporations and quasi-corporations, except those classified as the central bank, which are principally engaged in financial intermediation and whose business is to receive deposits and/or close substitutes for deposits from institutional units other than monetary financial intermediaries, and, for their own account, to grant loans and/or to make investments in securities. In general, (a) commercial banks, 'universal' banks, 'all-purpose' banks; (b) savings banks (including trustee savings banks and savings banks and loan associations); (c) post office giro institutions, post banks, giro banks; (d) rural credit banks, agricultural credit banks; (e) co-operative credit banks, credit unions; and (f) specialised banks (e.g. merchant banks, issuing houses, private banks) are all classified as CMFIs. Institutions engaged in granting mortgages (including building societies, mortgage banks and mortgage credit institutions), municipal credit institution,; and money market and cash funds may also be classified as CMFIs if they take deposits or issue close substitutes for deposits.

## Annex 1

### *Definitions of institutional units belonging to sub-sector S.123 (as numbered in the present SNA) in the context of the development of statistics for other financial intermediaries by the European System of Central Banks*

#### **Investment funds (IF)**

1. "Investment funds shall mean all collective investment undertakings (CIU) investing in financial and non-financial assets to the extent that their sole objective is the investment of capital raised from the public.<sup>18</sup> For the purpose of this definition, CIU shall include those undertakings the units/shares of which are, at the request of the holders, repurchased or redeemed directly or indirectly out of the undertaking's assets and those undertakings, the shares of which are fixed, and the holders entering or leaving the fund have to buy or sell existing shares. CIU within the meaning of this definition shall be constituted either: (i) under the law of contract (as common funds managed by management companies, or (ii) trust law (as unit trusts), or (iii) under a statute (as investment companies), or (iv) according to any other statement with similar effects.
2. This definition shall exclude pension funds. This definition shall also exclude investment funds issuing highly liquid liabilities of a monetary nature. The latter institutions, known as money market funds, would be classified in the sub-sector 'other depository corporations' (S.122)" (in the present SNA terminology).

#### **Financial vehicle corporations created to be the holders of securitised assets (FVC)**

3. "Financial Vehicle Corporations created to be the holder of securitised assets" (FVC) shall mean an undertaking that predominantly carries out one or more securitisations, the structure of which serves to isolate the FVC and the credit risk of the originator from each other.
4. FVC within the meaning of this definition shall be constituted either: (i) under the law of contract (as common funds managed by management companies), or (ii) under trust law, or (iii) under a statute (as a public limited company<sup>19</sup>), or (iv) according to any other arrangement with similar effects.
5. Within and for the purposes of this definition, securitisation means a financial transaction or scheme involving the transfer of assets or of risks underlying assets to a FVC created to hold securitised assets and to issue securities. In case of transferring government assets, these have to exist in the government's balance sheet before the arrangement starts and the transfer has to cover all risks contained in these assets. In case of a transfer of future receipts or in case when a full risk transfer does not take place, the respective securitisation vehicle would remain classified within the government sector.
6. Securities issues by FVC shall be open to the public or the securities are sold on the basis of a private placement.
7. This definition shall exclude depository corporations" (in the present SNA terminology).

<sup>18</sup> Investment funds can be set up as "funds" and as "companies".

<sup>19</sup> The term public applies here in the meaning of commercial law, different from the statistical concept of public sector.

### **Financial holding corporations (FHC)**

8. “Financial holding corporations (FHC) shall mean entities principally engaged in controlling financial corporations or groups of subsidiary financial corporations and that are not conducting business of such financial corporations themselves. For the purpose of this definition, an FHC secures control over a corporation by owning more than half of the voting shares, or by controlling more than half of the shareholders’ voting power, or by otherwise being able to determine the general corporate policy, or by controlling entities which control financial corporations or groups of subsidiary financial corporations. The criteria applied in order to identify FHC shall be derived from the instruments of incorporation, established statutes or by-laws, contracts, statutory financial reports or any other statement with similar effect of the FHC according to national regulatory provisions.”

### **Security and derivative dealers (SDD)**

9. “Security and derivative dealers”, classified as OFI, shall consist of all investment firms which are authorised to provide investment services for third parties by investing in securities on own account as their business. For the purpose of this definition, investment services are defined as follows:

10. Trading of new or outstanding financial instruments through the acquisition and sale of those financial instruments for the account and/or risk of the intermediary for the exclusive purpose of benefiting from the margin between the acquisition and selling price; this also includes market making activities;

11. Assisting firms in issuing new financial instruments through the placement of new financial instruments, that involve either a firm underwriting commitment or standby commitments to issuers of new issues.

12. These Security and Derivative Dealers shall be constituted according to national regulatory provisions<sup>20</sup>.”

### **Financial corporations engaged in lending (FLC)**

13. “Financial corporations engaged in lending (FCL) shall mean entities specialised in lending. For the purpose of this definition, lending activity comprises financial leasing<sup>21</sup>, factoring, mortgage lending, mutual guarantee, consumer lending and other type of lending as defined according to national regulatory provisions. FCL may be constituted under the legal form of a joint-stock company or limited liabilities company subject to a specialised legal national framework. Alternatively, the criteria applied in order to identify FCL shall be derived from the instruments of incorporation, established statutes or by-laws, contracts, statutory financial reports or any other statement with similar effect of the FCL.

14. This definition shall exclude intermediaries classified as depository corporations” (in the present SNA terminology).

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20 This definition shall exclude credit institutions

21 For statistical purposes, leasing is defined as financial leasing when the leasing period covers all or most of the economic lifetime of the durable good. At the end of the leasing period, the lessee often has the option to buy the good at a nominal price (ESA 95, Annex II).