Working Party on Financial Statistics

Identifying holding companies and SPEs in the wake of the ESA 2010 implementation: a contribute from Banco de Portugal

Common day

To be held on 3 October 2012
OECD Conference Centre
Beginning at 9:00 a.m.

This document has been prepared by Ana Margarida Almeida (Bank of Portugal) and will be presented under item 4 of the draft agenda

The complete document is only available in PDF format
Identifying holding companies and SPEs in the wake of the ESA 2010 implementation: a contribute from Banco de Portugal

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   1.3 A decision tree for the sector classification of SPEs
   1.4 The sub-sector of Captive financial institutions and money lenders
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1. New international manuals methodological guidance for sector breakdowns

1.1 The institutional sectors

**ESA 95**

- **S.11**: Non-financial corporations (including non-financial holdings)
- **S.12**: Financial corporations
  - **S.121**: CB
  - **S.122**: OMFI
  - **S.123**: OFI (including financial holdings)
  - **S.124**: FA
  - **S.125**: ICPF
- **S.13**: General government
- **S.14**: Households
- **S.15**: Non-profit institutions serving households

**ESA 2010**

- **S.11**: Non-financial corporations
- **S.12**: Financial corporations
  - **S.121**: CB
  - **S.122**: OMFI
  - **S.123**: MMF
  - **S.124**: Non-MMF IF
  - **S.125**: OFI
  - **S.126**: FA
  - **S.127**: Captive FI and money lenders
  - **S.128**: IC
  - **S.129**: PF
- **S.13**: General government
- **S.14**: Households
- **S.15**: Non-profit institutions serving households

1.2 Head-offices, holdings and SPEs

From ESA 2010 (version of August 2012):

Head offices and holding companies

2.14 Head offices and holding companies are institutional units. The two types are:

a) A head office is a unit that exercises managerial control over its subsidiaries. Head offices are allocated to the dominant non-financial corporations’ sector of their subsidiaries, unless all or most of their subsidiaries are financial corporations, in which case they are treated as financial auxiliaries (S.126) in the financial corporations’ sector. Head offices are described under International Standard Industrial Classification of All Economic Activities Revision (ISIC Rev. 4), class 7010 (NACE Rev. 2).

b) A holding company that holds the assets of subsidiary corporations but does not undertake any management activities is a captive financial institution (S.127) and classified as a financial corporation. Holding companies are described under ISIC Rev.4, class 6420 (NACE Rev. 2).
1.2 Head-offices, holdings and SPEs

Special Purpose Entities

2.18 There is no common definition of an SPE, but the following characteristics are typical:

a) They **have no employees and no non-financial assets**;
b) They have little physical presence beyond a ‘**brass plate**’ confirming their place of registration;
c) They are always related to another corporation, often as a **subsidiary**;
d) They are **resident in a different territory** from the territory of residence of the related corporations. In the absence of any physical presence an enterprise's residence is determined according to the economic territory under whose laws the enterprise is incorporated or registered;
e) They are **managed by employees of another corporation** which may or may not be a related one. The SPE **pays fees for services provided to it and in turn charges its parent or other related corporation a fee to cover these costs**. This is the only production the SPE is involved in, although it will often incur liabilities on behalf of its owner and will usually receive investment income and holding gains on the assets it holds.
1.2 Head-offices, holdings and SPEs

Special Purpose Entities

2.19 Whether a unit has all or none of these characteristics, and whether it is described as an SPE or some similar designation or not, it shall be treated in the same way as any other institutional unit by being allocated to sector and industry according to its principal activity unless the SPE has no independent rights of action.

2.28 In summary, the accounts of Special Purpose Entities with no independent rights of action are consolidated with the parent corporation, unless they are resident in a different economy from that of the parent. There is one exception to this general rule, and that is when a non-resident SPE is set up by government (rerouting).
1.2 Head-offices, holdings and SPEs

### ESA 1995

- **Head Offices**: S.11 (NFC)
- **Holdings**: Financial Holdings (OFI, S.123)
- **SPE**: S.11 (NFC), S.12 (FC)...

### ESA 2010

- **Head Offices**: S.11 (NFC)
- **Holdings**: Financial (Captive FI, S.127)
- **Non-Financial Holdings**: (S.11)
- **SPE**: S.11 (NFC), S.12 (FC)...

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S.126 (FA) (§2.14) (“if most of their subsidiaries are financial corporations”)

Identifying holding companies and SPEs in the wake of ESA 2010 implementation: a contribute from Banco de Portugal

1.3 A decision tree for the sector classification of SPEs

Is the SPE a resident unit?

- yes
  - Is the entity controlled by a foreign institutional unit?
    - yes
      - The entity should be treated in the same way as any other institutional unit and should be allocated to sector according to its principal activity.
    - no
      - Is the entity controlled by another resident institutional unit?
        - yes
          - Can the entity act independently of its parent?
            - yes
              - Is the entity a Special purpose unit of General Government?
                - yes
                  - The entity is treated as an integral part of GG (S.13)
                - no
                  - The entity is not an institutional unit and is consolidated with the parent resident institutional unit (artificial subsidiaries of corporations). (S.127)
            - no
              - The entity should be classified in the non-resident sector (S.2).
          - Is the entity a Special purpose unit of General Government?
            - yes
              - The entity is treated as an integral part of GG (S.13)
            - no
              - The entity should be classified in the non-resident sector (S.2).

If the entity is a special purpose unit of GG, it should be treated as a separate unit. Any transactions carried out by them abroad are reflected in corresponding transactions with government (rerouting).
1.4 The institutional sub-sector of Captive financial institutions and money lenders

Captive financial institutions and money lenders (S.127)

“Financial corporations and quasi-corporations which are neither engaged in financial intermediations nor in providing financial auxiliary services and where most of either their assets or their liabilities are not transacted on open markets.” (ESA 2010, §2.98)
The methodological manuals do not provide a common and unique definition of SPE; they present typical characteristics (ESA2010, § 2.18) leaving room for interpretation (for instance, in *Impact of globalization on national accounts, June 2011*).

Some guidance is given in order to help countries to identify this type of entities.

Countries identify such entities according to their own experience: how to identify, in the Portuguese case, the entities that will need to be reclassified from the non-financial corporations’ sector (S.11) to the financial corporations’ sector (S.12)?
Institutional sector and economic activity sector (NACE) classifications

- **National Statistics Institute**
  - institutional sectors’ definition and boundaries
  - responsible for validating the NACE code

- **Banco de Portugal**
  - **financial sector** definition and boundaries:
    - financial holdings - information reported quarterly / bi-annually for supervisory purposes to the Prudential Supervision Department;
    - identification of the holding companies moving from the non-financial to the financial sector, assessing the quantitative macro-impact of the sectoral change.
Holding companies

*Banco de Portugal* tested two hypothesis:

**Hypothesis 1** – Maintaining the **NACE attributed at the origin** in the Corporate Business Register and reclassifying the entities with NACE 6420 “Activities of holding companies” to S.127 “Captive FI and money lenders”;

**Hypothesis 2** – Analysing which **quantitative criteria** would be more appropriate in order to reflect the new international manuals methodological guidance.
Hypothesis 1 – NACE

**Data source:** Corporate business register (information on NACE code, corporation identification number, name, registered capital)

- Strong correlation between economic activity (NACE) and institutional sector
- Approximately 4,200 holding companies (2011) move from NFC (S.11) to Captive FI (S.127)
- Reallocation of all the corporations with NACE 6420 from Non-financial corporations (S.11) to Captive Financial Institutions (S.127)
- Approximately 36% of NFC (S.11) capital shares (2011) shift to Financial sector
Hypothesis 1 – NACE

Problems with NACE code:

The code is assigned/selected by the company itself when registering and in some cases it may not be the correct one:

- Some companies with code 6420 are not holding companies;
- Some companies with other NACE codes are, in fact, holding companies;
- Small number of companies with head office code (7010) ≈ 160.

### 2.2 The Portuguese experience in analysing holding companies

**Comparing with IES (Informação Empresarial Simplificada) Simplified Corporate Information**

IES is the Portuguese acronym for the simplified reporting system for corporate information, through the electronic submission of accounting, fiscal and statistical information that companies have to remit yearly, on a mandatory basis, to the Ministry of Justice, the Ministry of Finance, the National Statistics Institute and the Banco de Portugal.

<table>
<thead>
<tr>
<th>NACE code</th>
<th>Corporate Business Register (CBR)</th>
<th>Informação Empresarial Simplificada (IES 2011)</th>
<th>Coverage of CBR by IES</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Nr. companies</td>
<td>Nr. companies</td>
<td>Total Assets (% GDP)</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>SPE (RoW)</td>
<td>Total</td>
</tr>
<tr>
<td>6420 Holdings</td>
<td>≈ 4 200</td>
<td>≈ 100</td>
<td>≈ 3 200</td>
</tr>
<tr>
<td>7010 Head Offices</td>
<td>≈ 160</td>
<td>0</td>
<td>≈ 130</td>
</tr>
</tbody>
</table>

Hypothesis 2 – Using quantitative criteria

- “A holding company that simply owns the assets of subsidiaries is one example of a captive financial institution”
- “Entities of this type are commonly managed by employees of another corporation which may or may not be a related one”
- “Strong financial component”

Services provided = 0 ?
Commodities sold = 0?
Number of workers ≤ 5?
Financial Assets/Total Assets ≥ 80% ?
# Hypothesis 2 – Using quantitative criteria

(Preliinary results from IES 2011)

How many Non-financial holding companies to be included in S.127? Different answers according to the quantitative criteria selected

<table>
<thead>
<tr>
<th></th>
<th>Nr. of companies</th>
<th>Total Assets (% of GDP)</th>
<th>Nr. of companies needed to cover 95% of Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total non-financial holdings</td>
<td>≈ 3 200</td>
<td>≈ 111%</td>
<td>≈ 780</td>
</tr>
<tr>
<td>1) Services = 0</td>
<td>≈ 2 300</td>
<td>≈ 62%</td>
<td>≈ 570</td>
</tr>
<tr>
<td>2) Commodities sold = 0</td>
<td>≈ 3 180</td>
<td>≈ 110%</td>
<td>≈ 770</td>
</tr>
<tr>
<td>3 a) Workers ≤ 5</td>
<td>≈ 2 960</td>
<td>≈ 60%</td>
<td>≈ 900</td>
</tr>
<tr>
<td>3 b) Workers ≤ 10</td>
<td>≈ 3 080</td>
<td>≈ 71%</td>
<td>≈ 910</td>
</tr>
<tr>
<td>Of which workers = 0</td>
<td>≈ 2 020</td>
<td>≈ 32%</td>
<td>≈ 630</td>
</tr>
<tr>
<td>4) Financial Assets/Total assets ≥ 80%</td>
<td>≈ 1 250</td>
<td>≈ 38%</td>
<td>≈ 450</td>
</tr>
<tr>
<td>3 a) + 4)</td>
<td>≈ 1 160</td>
<td>≈ 21%</td>
<td>≈ 500</td>
</tr>
<tr>
<td>1) + 2) + 3 b)</td>
<td>≈ 2 260</td>
<td>≈ 53%</td>
<td>≈ 600</td>
</tr>
</tbody>
</table>
2.2 The Portuguese experience in analysing holding companies

Assessing the impact - Total Assets

Different criteria lead to different results which will influence the analysis of S.11 and S.127!

Hypothesis 1

- NACE

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<tr>
<td>HH + NPSH (S.14/15)</td>
<td>22%</td>
</tr>
<tr>
<td>NFC (S.11)</td>
<td>24%</td>
</tr>
<tr>
<td>GG (S.13)</td>
<td>6%</td>
</tr>
<tr>
<td>FC (S.12)</td>
<td>48%</td>
</tr>
</tbody>
</table>

NFC: -11%
FC: + 11%

Hypothesis 2

- Using quantitative measures: 3 a) + 4)

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</table>

NFC: -2%
FC: +2%

(Hyp2 – Hyp1) Debt-to-equity ratio 87%
(Hyp2 – Hyp1) Debt-to-GDP ratio 49%

2.3 The Portuguese experience in analysing SPEs

SPEs

General criteria to assist compilers to identify SPEs: (...) ii) The enterprise is ultimately controlled by a non-resident parent, directly or indirectly. (…) 2008 4th edition of the OECD Benchmark Definition of Foreign Direct Investment, Box 6.2

In practice, it does not seem possible to use quantitative criteria for characterising SPEs different than the ones used for characterising holdings (besides assessing the variable “control”)

- Have links established with other entities (usually their subsidiaries)
  - Existing control?
  - They are usually resident in territories different from those where are the related entities
  - Controlled by non-residents?
2.3 The Portuguese experience in analysing SPEs in bop/iip statistics – work in progress

Is it a resident Unit?

- Yes → Is it controlled by non-resident entities directly or indirectly (more than 50% of capital)?
  - Yes → It has less than 10 employees?
    - Yes → SPE
    - No → It has more than 2 employees?
      - Yes → SPE
      - No → It has a turnover higher than 3 million euro?
        - Yes → SPE
        - No → Non-resident
  - No → SPE

- No → Non-resident
3. Conclusions and way forward

Portugal

- Problems with the initial allocation of NACE code
- Quarterly direct reporting from companies? 500 companies represent 95% of the Total Assets (IES 2011)
- Periodically reevaluate the population (holding companies that should be included in S.127), based on the IES information

- Defining procedures for attributing financial NACE codes when a company is registered (BP, ISP, CMVM)
- Streamline procedures for reviewing the NACE codes by the NSI
- Using as much as possible the information already available with a higher frequency in other databases at Banco de Portugal (Central Credit Register; Securities Issues and Holding Statistics)
- Required joint work between NSI and Banco de Portugal (list of head offices vis-à-vis list of holdings)
- Disclose the list of holding companies that should be considered in S.127

3. Conclusions and way forward

And in Europe?

- Advantages of having an harmonized definition among EU countries for classifying financial holding and head offices
- Discussing difficult cases: consolidation with the parent company, how to assess lack of autonomy of decision...

- Define a periodicity for reviewing the population of financial holdings and head offices
- Disclose a list of holding companies that should be considered in S.127 in each country

Collaboration among international organisations (ECB, Eurostat, OECD), at the level of the different WG work programs

Joint Task-Force (CMFB)

Annually or at larger time intervals?

Including some information on ISIN codes of securities issued?
Thank you for your attention!

Questions?