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Sub-sectoring of the financial corporation

Delineation of the Financial Sector in ESA 2010: Implementation in the Netherlands

Note by Statistics Netherlands

Summary

This paper refers to the Netherlands' experience in implementing the new recommendations in the System of National Accounts (SNA) 2008 and the European System of Accounts (ESA) 2010 regarding the delineation and sub-sectoring of the financial corporations sector. Throughout the paper references to the relevant ESA 2010 paragraphs are given. With this contribution, Statistics Netherlands aims to inform other countries implementing ESA 2010 and to provide an input for the international discussion on the delineation and sub-sectoring of the financial corporations sector. The revised Dutch National Accounts will be published in 2014.

I. Introduction

1. The System of National Accounts (SNA) 2008 and the European System of Accounts (ESA) 2010[1] give new recommendations for the delineation and sub-sectoring of the financial corporations sector. This paper describes the implementation of these new recommendations by Statistics Netherlands[2], with references to the relevant ESA 2010 paragraphs. The experiences so far in the Netherlands may be useful to other countries implementing ESA 2010, and may serve as input for the international discussion on the delineation and sub-sectoring of the financial corporations sector. The financial corporations sector is divided into nine subsectors (par 2.66). Figure 1 shows the relation between the ESA 1995 and the ESA 2010 subsectors.

Figure 1

Subsectors of the financial corporations sector, according to ESA 1995 and ESA 2010

ESA 1995		ESA 2010
S.121 The central bank	→	S.121 Central bank
S.122 Other monetary financial institutions	→	S.122 Deposit-taking corporations, except the central bank S.123 Money market funds (MMF)
S.123 Other financial intermediaries, except insurance corporations and pension funds S.124 Financial auxiliaries	→	S.124 Non-MMF investment funds S.125 Other financial intermediaries, except insurance corporations and pension funds S.126 Financial auxiliaries S.127 Captive financial institutions and money lenders
S.125 Insurance corporations and pension funds	→	S.128 Insurance corporations S.129 Pension funds

2. Subsector S.121 Central bank is unchanged. ESA 1995 subsector S.122 has been divided into ESA 2010 subsectors S.122 Deposit-taking corporations, except the central bank, and S.123 Money market funds (MMF). The other financial institutions (except insurance corporations and pension funds) will be classified in four ESA 2010 subsectors: S.124 Non-MMF investment funds, S.125. Other financial intermediaries, except insurance corporations and pension funds, S.126 Financial auxiliaries, and S.127 Captive financial institutions and money lenders. The insurance corporations and pension funds have been split up in subsectors S.128 and S.129.

3. In the Netherlands, the most important conversions from ESA 1995 to ESA 2010 subsectors concern the following financial corporations: money market funds (described in paragraph 2), electronic money institutions classified in subsector S.122 (paragraph 3), financial vehicle corporations as part of subsector S.125 (paragraph 4), and captive financial institutions and money lenders (paragraph 5). The sub-sectoring of captive financial institutions also relates to the distinction between head offices and holding companies (paragraph 5.1). Further, the delineation of special purpose entities in subsector S.127 will be discussed (paragraph 5.2).

II. Money market funds

4. In ESA 2010, the money market funds (MMF) are explicitly excluded from the definition of subsector S.122 Deposit-taking corporations except the central bank. ESA

1 ESA 2010 Manual, DRAFT, 20 December 2010.

2 Special thanks go to Tom van Venrooij for his research on the interpretation of the financial sector delineation according ESA 2010.

2010 paragraph 2.75 states: "The subsector deposit-taking corporations except the central bank (S.122) includes all financial corporations and quasi-corporations, except those classified in the central bank and in the MMF subsectors, which are principally engaged in financial intermediation and whose business is to receive deposits from institutional units, and, for their own account, to grant loans and/or to make investments in securities." They now belong to the new subsector S.123 Money market funds: investment funds including investment trusts, unit trusts and other collective investment schemes whose shares or units are close substitutes for deposits (par 2.80).

5. Subsector S.123 is defined as "collective investment schemes consisting of all financial corporations and quasi-corporations, except those classified in the central bank and in the credit institutions subsectors, which are principally engaged in financial intermediation. Their business is to receive investment fund shares or units as close substitutes for deposits from institutional units, and, for their own account, to make investments primarily in money market fund shares/units, short-term debt securities, and/or deposits" (par 2.79). Concluding, MMFs issue MMF shares or units (F.521), which are close substitutes for deposits (par 5.164), and they make investments in short-term assets.

6. In the Netherlands MMFs are very small. Detailed data are available until the third quarter of 2008. Figure 2 shows the balance sheet of MMFs at the end of the third quarter of 2008.

Figure 2
Money market funds, balance sheet 2008Q3 (mln. euros)

Assets		Liabilities	
Transferable deposits (F.22)	798	Short-term loans (F.41)	1621
Short-term debt securities (F.31)	1560	Investment fund shares or units (F.52)	936
Investment fund shares or units (F.52)	106		
Options and warrants (F.71)	3		
Other accounts receivable (F.89)	90		
Total	2557	Total	2557

7. The balance structure of non-MMF investment funds is completely different. In paragraph 2.82, they are defined as "all collective investment schemes, except those classified in the MMF subsector, which are principally engaged in financial intermediation. Their business is to receive from institutional units, investment fund shares or units which are not close substitutes for deposits, and on their own account, to make investments primarily in financial assets other than short-term financial assets and in non-financial assets (usually real estate)." Figure 3 gives the revised balance sheet of non-MMF investment funds at the end of the fourth quarter of 2008, which is the first period that has currently been revised.

Figure 3
Non-MMF investment funds, balance sheet 2008Q4 (mln. euros)[3]

Assets		Liabilities	
Transferable deposits (F.22)	4440	Long-term debt securities (F.32)	176
Other deposits (F.29).	696	Short-term loans (F.41)	2432
Short-term debt securities (F.31)	643	Long-term loans (F.42)	6516
Long-term debt securities (F.32)	61617	Investment fund shares or units (F.52)	174916
Short-term loans (F.41)	2252	Financial derivatives (F.71)	2366
Long-term loans (F.42)	9040	Trade credit and advances (F.81)	311
Equity (F.51)	51144	Other accounts receivable (F.89)	2037
Investment fund shares or units (F.52)	34804		
Financial derivatives (F.71)	3734		
Trade credit and advances (F.81)	16		
Other accounts receivable (F.89)	2795		
Produced non-financial assets (AN.1)	17573		
Total	188754	Total	188754

8. Since the fourth quarter of 2008, the Dutch Central Bank (DNB) has changed the reporting requirements of MMFs and investment funds. Because MMFs are so small, the data requested from them have been limited. Currently, MMFs only report to DNB their total assets, on a yearly basis. It is a challenge to compile National Accounts for the new subsector S.123 Money market funds, because, besides the lack of data, MMFs have a characteristic balance sheet structure. As a practical way out, Statistics Netherlands has taken the balance sheet of MMFs in the third quarter of 2008 as a basis, while estimating the transactions characteristic for MMFs on developments of these assets/liabilities in other subsectors.

III. Electronic money institutions

9. A relatively new kind of ‘banks’ are the electronic money institutions. In ESA 2010, the electronic money institutions principally engaged in financial intermediation[4] have been added to the list of financial intermediaries classified in subsector S.122 Deposit-taking corporations except the central bank (par 2.76). In the Netherlands, “Binckbank” is an example of such an electronic money institution. “Binckbank” is an internetbank for private and professional investors and is listed on the NYSE Euronext stock exchange in Amsterdam. In 2011 this online bank executed almost 9 million transactions and managed total assets of 14 billion euros. Although the business of “Binckbank” might indicate this company is a broker or investment fund, Statistics Netherlands will classify “Binckbank” in subsector S.122, because this company has a banking-license.

IV. Financial vehicle corporations

10. Financial vehicle corporations (FVC) are part of subsector S.125 Other financial intermediaries, except insurance corporations and pension funds, consisting of “all financial corporations and quasi-corporations which are principally engaged in financial

[3] According to the National Accounts revision policy of Statistics Netherlands, ESA 2010 will be implemented in 2014. The revised data in figure 3 are provisional.
[4] Paragraph 2.78 underlines the criteria of being principally engaged in financial intermediation: “Subsector S.122 does not include electronic money institutions not principally engaged in financial intermediation.”

intermediation by incurring liabilities in forms other than currency, deposits, investment fund shares, or in relation to insurance, pension and standardised guarantee schemes from institutional units" (par 2.86). As seen before with other subsectors, the maturity of the liabilities gives guidance to the delineation of this subsector. Paragraph 2.87 explains: "Subsector S.125 includes financial intermediaries predominantly engaged in longterm financing." In paragraph 2.88, subsector S.125 is further subdivided into subsectors consisting of:

- Financial vehicle corporations engaged in securitisation transactions (FVC);
- Security and derivative dealers;
- Financial corporations engaged in lending, and;
- Specialised financial corporations.[5]

11. In the Netherlands, about 60 per cent[6] of the total balance sheet of other financial intermediaries can be attributed to the FVCs, which paragraph 2.90 defines as "undertakings carrying out securitisation transactions. FVCs that satisfy the criteria of an institutional unit are classified in S.125, otherwise they are treated as an integral part of the parent corporation." The business of FVCs is briefly described as carrying out securitisation transactions. Paragraph 5.104 explains: "Securitisation is the issuance of debt securities for which coupon or principal payments are backed by specified assets or by future income streams. A variety of assets or future income streams may be securitised including, among others, residential and commercial mortgage loans; consumer loans; corporate loans, government loans; insurance contracts; credit derivatives; and future revenue."

12. Further, an important point made in paragraph 2.90 is that FVCs must satisfy the criteria of an institutional unit. These criteria are worked out in paragraph 5.108:

"It is essential to establish whether the financial corporation engaged in the securitisation of assets actively manages its portfolio by issuing debt securities and bearing risk, rather than simply acting as a trust that passively manages assets or holds debt securities. When the financial corporation is the legal owner of a portfolio of assets, issues debt securities that present an interest in the portfolio, has a full set of accounts, and bears market and credit risks, it is acting as a financial intermediary classified in other financial intermediaries. Financial corporations engaged in the securitisation of assets, also called financial vehicle corporations (FVC), usually don't bear the market or the credit risk, since any change in the value of the assets they hold due to those risks is compensated on a one-to-one basis by a decrease in the principal and/or interest to be paid to the holders of the asset-backed securities (ABS). Credit rating agencies also insist that the securitisation corporations are completely insolvency-proof. Financial corporations engaged in the securitisation of assets are distinguished from entities that are created solely to hold specific portfolios of financial assets and liabilities. These entities are combined with their parent corporation, if resident in the same country as the parent. However, as non-resident entities they are treated as separate institutional units and are classified as captive financial institutions."

13. In summary, a FVC will be classified in subsector S.125 if this corporation:

- Is the legal owner of a portfolio of assets;
- Issues debt securities that present an interest in the portfolio;
- Has a full set of accounts;

[5] Statistics Netherlands will also classify municipal credit and savings banks in subsector S.125 Other financial intermediaries, except insurance corporations and pension funds. This is in accordance with ESA 2010 paragraph 2.62.

[6] This percentage is based on provisional revised data of 2011 (excluding holding companies).

- Bears market and credit risks.

14. If a FVC solely holds specific portfolios of financial assets and liabilities, it is consolidated with its domestic parent company. If such an entity has a foreign parent company, it is treated as a separate institutional unit and it will be classified as a captive financial institution in subsector S.127.

15. In the Netherlands, the population of the FVCs is evaluated on the basis of these criteria. This is pursued by the Dutch Central Bank (DNB) in cooperation with Statistics Netherlands. The FVCs report to DNB, which transmits quarterly and yearly data on FVCs to Statistics Netherlands, for the compilation of National Accounts. DNB is actively scouting potential FVCs. When a potential FVC is identified, it is asked to fill in a registration form (figure 4).

Figure 4

Registration form financial vehicle corporations

DETAILS OF SECURITISATION
What is the type of the securitisation? (Please tick as applicable)
True sale . .
Synthetic . .
Other . . (Please explain in column "6. NOTES")

What is/are the name('s) of the Dutch originator(s) (if applicable)

ASSETS
What is the nature of the securitisized assets? (Please tick as applicable)
Residential mortgages . .
Other mortgages than residential mortgages . .
Corporate loans . .
Consumer loans . .
Securities . .
Real estate . .
Other . . (Please explain in column "6. NOTES")

What is the percentage proportion of the country of the originator('s)?
Netherlands . . . %
Euro area (excluding the Netherlands) . . . %
Rest of the world . . . %

What is the percentage proportion between the sectors of the originator('s) insofar as within the euro area (including the Netherlands)? (if applicable)
Banks . . . %
Insurance corporations . . . %
Special purpose vehicles . . . %
Non-financial corporations . . . %
Pension funds . . . %
Investment funds . . . %
Other financial intermediaries . . . %
General government . . . %

LIABILITIES
What is the expected date of the issuance?
. . - . . - 201 .

Will the global note of the securities to be issued be deposited with a domestic or foreign (central) securities depository?
Domestic . .
Foreign . .
Not applicable . .

What is the ISIN-code of the largest issuance?

FINANCIAL DATA (company balance sheet)
Attention! Securities issued by the SPV insofar as deposited with a foreign (Central) Securities Depository (i.e. global note is not deposited with Euroclear Nederland) are considered as foreign liabilities!
(Estimated) balance sheet total after issuance:
Assets (amounts in € x 1,000)
Total foreign assets
Total domestic assets
Total assets
Liabilities (amounts in € x 1000)
Total foreign liabilities
Total domestic liabilities
Total liabilities

16. In case of true sale securitisations both assets and risk are transferred from the originator to the FVC. In case of synthetic securitisations the assets remain on the balance sheet of the originator but the risk is transferred from the originator to the FVC. In both cases the corporations are classified as FVC. Further, the securitised assets or future income streams are specified (like in par 5.104). The financial data (company balance sheet)

indicate that the company has a full set of accounts. This registration form is used to check on the criteria mentioned above and to identify a corporation as FVC.

V. Captive financial institutions and money lenders

17. A new subsector in ESA 2010 is subsector S.127 Captive financial institutions and money lenders, consisting of "all financial corporations and quasi-corporations which are neither engaged in financial intermediation nor in providing financial auxiliary services and where most of either their assets or their liabilities are not transacted on open markets (par 2.98)." In particular, according to paragraph 2.99, the following financial corporations and quasi-corporations are classified in subsector S.127:

(a) Units as legal entities such as trusts, estates, agencies accounts or brass plate companies;

(b) Holding companies that hold owning controlling-levels of equity of a group of subsidiary corporations and whose principal activity is owning the group without providing any other service to the businesses in which the equity is held, that is, they do not administer or manage other units;

(c) Special Purpose Entities (SPE) that qualify as institutional units and raise funds in open markets to be used by their parent corporation;

(d) Units which provide financial services exclusively with own funds, or funds provided by a sponsor, to a range of clients and incur the financial risk of the debtor defaulting. Examples are money lenders, corporations engaged in lending to students or for foreign trade from funds received from a sponsor such as a government unit or non-profit institution, and pawnshops that predominantly engage in lending;

(e) Special purpose government funds, usually called sovereign wealth funds, if classified as financial corporations.

Two of these examples, holding companies and special purpose entities, will be discussed in more detail.

A. Head offices and holding companies

18. In ESA 2010, a distinction has been made between head offices and holding companies. They are classified in subsectors S.126 and S.127 respectively. Subsector S.126 Financial auxiliaries consists of all financial corporations and quasi-corporations which are principally engaged in activities closely related to financial intermediation but which are not financial intermediaries themselves (par 2.95), and also includes head offices whose subsidiaries are all or mostly financial corporations (par 2.97). Paragraph 2.14 explains the difference between head offices and holding companies in more detail: "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;

Where there is a mixture of non-financial and financial subsidiaries, then the predominant share by value added determines the sector classification. Where the head office undertakes business production, and this business activity is predominant, then the head office is classified to the business sector. Head offices are described under ISIC Rev. 4, Section M, class 7010 (NACE Rev. 2, M 70.10) as follows:

"This class includes the overseeing and managing of other units of the company or enterprise; undertaking strategic or organisational planning and decision-making role of the company or enterprise; exercising operational control and managing the day-to-day operation of their related units."

(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, section K, class 6420 (NACE Rev. 2, K 64.20), as follows:

"This class includes the activities of holding companies, i.e. units that hold the assets (owning controlling-levels of equity) of a group of subsidiary corporations and whose principal activity is owning the group. The holding companies in this class do not provide any other service to the businesses in which the equity is held, i.e. they do not administer or manage other units."

19. Summarizing, the business of a head office can be described with the catchwords:

- Managerial control;
- Strategic/organisational planning/decision-making;
- Operational control.

20. On the contrary, the business of a holding company is matched by the phrases:

- Does not undertake any management activities;
- Do not provide any other service to the businesses in which the equity is held;
- Do not administer/manage other units.

21. In practice, the distinction between head offices and holding companies might be much more difficult. Statistics Netherlands will use annual reports of head offices/holding companies to find out if the phrases mentioned above apply to the business described in these reports. So, it will be checked if an entity undertakes management activities like planning and decision-making, and exercises operational control of a group of subsidiary corporations. Further research is necessary to properly define the population of head offices and holding companies.

B. Special purpose entities

22. ESA 2010 finds it difficult to give a definition of special purpose entities (SPE), so it uses a description: "A special purpose entity (SPE) or vehicle (SPV) is usually a limited company or, a limited partnership, created to fulfil narrow, specific or temporary objectives, to isolate a financial risk, a specific taxation or a regulatory risk" (par 2.17). According to paragraph 2.18, 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 substance to an enterprise, its 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 rendered 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.

23. Above all, when an entity has the characteristics of a SPE, but has no independent rights of action, paragraph 2.23 gives guidance: "An entity of this type that cannot act independently of its parent and is simply a passive holder of assets and liabilities (sometimes described as being on auto-pilot) is not treated as a separate institutional unit unless it is resident in an economy different from that of its parent. If it is resident in the same economy as its parent, it is treated as an 'artificial subsidiary' as described below."

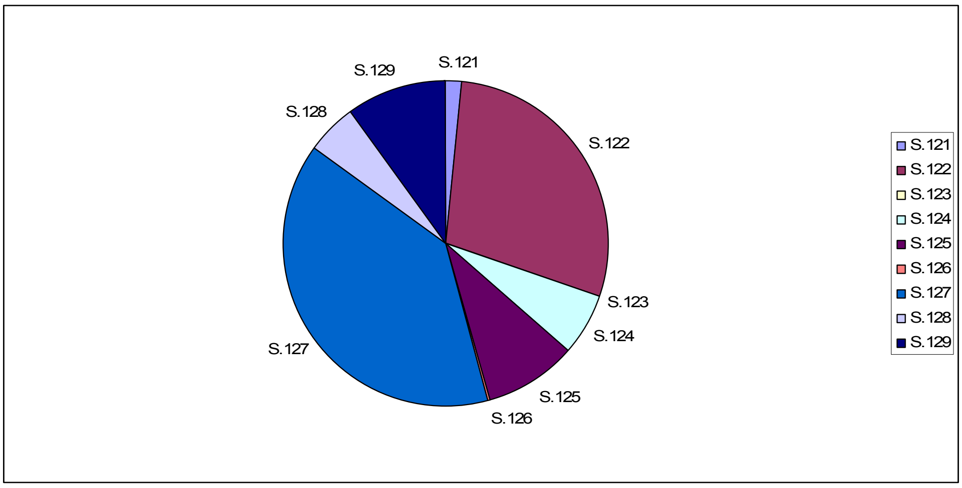
24. The term artificial subsidiary is worked out in paragraph 2.25: "In general, these sorts of entities do not satisfy the definition of an institutional unit because they lack the ability to act independently from their parent corporation and may be subject to restrictions on their ability to hold or transact assets held on their balance sheets. Their level of output and the price they receive for it are determined by the parent that (possibly with other corporations in the same group) is their sole client. They are thus not treated as separate institutional units but are treated as an integral part of the parent and their accounts are consolidated with those of the parent, unless they are resident in an economy different from that where the parent is resident."

25. Summarizing, a SPE that cannot act independently of its domestic parent, is treated as an artificial subsidiary and is consolidated with its parent company. However, if such an entity without independent rights of action is related to a foreign parent company, it is treated as a separate institutional unit and classified as a captive financial institution in subsector S.127.

26. The term "parent company" is interpreted by Statistics Netherlands as the direct parent company, not as the ultimate mother company. Otherwise, many artificial subsidiaries would be classified in subsector S.127. Consider for example a financial entity A that cannot act independently from its direct parent company B (a head office) and which is resident in the same economy as B. Further, entity A is resident in an economy different from that of its ultimate mother C. When the term parent company could be interpreted as ultimate mother company, then entity A would be classified in subsector S.127. However, when the term parent company indicates the direct parent company, entity A would be an artificial subsidiary and be classified in the same subsector as B (subsector S.126).

27. In the Netherlands, SPEs are relatively important. Figure 5 shows the share of the financial subsectors (S.121-S.127) in the total financial corporations sector (S.12), based on the revised total balance sheet of 2009.

Figure 5
Share of subsectors S.121-127 in sector S.12 (total balance of 2009)[7]



28. The total balance sheet of subsector S.127 amounts to 39 per cent of the total balance sheet of sector S.12. The impact of SPEs on the financial corporations sector is very substantial. In 2009, there were approximately 14,000 SPEs in the Netherlands. Statistics Netherlands and the Dutch Central Bank (DNB) have jointly developed a decision tree to determine whether an entity is a SPE. This decision tree also determines whether an entity will be consolidated with its parent corporation, or is a separate institutional unit to be classified in subsector S.127 (figure 6).

[7] The diagram is based on provisional revised data of 2009. Since the distinction between head offices and holding companies is subject of research, these are still classified in subsector S.125. The total balance sheet of head offices/holding companies is about 23 per cent of the total of subsector S.125.

Figure 6
Decision tree SPE/subsector S.127

Decision Tree SPE/not SPE

Is the legal entity (LE) resident in The Netherlands?

NO → Not in statistics

YES

↓

Is the ultimate control over the LE in direct/indirect ownership of one or more (joint venture) foreign entities for more than 50%?

NO → Go to **2**

YES

↓

Does at least 90% of the turnover concern the export of services of royalties and licences?

OR

Does at least 90% of the turnover and costs concern reinvoicing with foreign intra-concern subsidiaries?

OR

Does at least 90% of the turnover and the liabilities concern foreign countries?

OR

1. Do the financial assets and liabilities of the LE (excl. trade credit/advances) consist of at least 90% of foreign assets/liabilities?

NO → Not SPE

YES

↓

Is domestic annual turnover of the LE higher than 25 million euro?

NO → SPE

YES → Discussion SPE/not SPE

2. Is the LE a SPV with foreign originator AND does the LE satisfy the assets/liabilities criterium (1)?

NO → Not SPE

YES → SPE

Decision Tree S.127/not S.127

Is the legal entity (LE) resident in The Netherlands?

NO → Not in statistics

YES

↓

Is the LE a SPE?

YES → Subsector S.127

NO

↓

Is the LE a holding/finance company/treasury without management/administration tasks?

NO → Other subsector than S.127

YES

Does the LE have, direct or indirect, a domestic parent which itself is not a CFI?

YES → Subsector of the first (in)direct non-CFI parent

NO

↓

Is the LE with its financial assets/liabilities primarily oriented (direct/indirect) towards non-SPE intra-concern subsidiaries?

YES → Subsector of the greatest non-SPE intra-concern subsidiary

NO → Subsector S.127

29. The first part of the decision tree decides whether an entity is a SPE or not. The questions asked have the purpose to determine if an entity is resident in an economy different from that of its parent company. The criteria of 90 per cent is arbitrary. If the turnover of an entity is primarily from abroad and is diverted to foreign intra-concern subsidiaries, it is considered as a SPE. Sometimes, the assets of lease companies are not registered abroad and are non-financial. Therefore, the assets/liabilities criteria is mentioned to identify such an entity as a SPE. Further, the criteria of domestic annual turnover higher than 25 million euros is used. Production is much better reported by non-financial corporations than by SPEs, so it might be undesirable to classify an entity with high production as a SPE instead of a non-financial corporation. A special group of SPEs are the FVC-SPEs, which do not have a foreign parent company but do satisfy the assets/liabilities criteria.

30. The second part of the decision tree decides whether an entity is classified in subsector S.127 or not. If an entity is a holding company without management or administration tasks (like described in par 2.14), it is a potential captive financial institution (CFI). If such an entity has a domestic parent company, it will be treated as an artificial subsidiary. It will be consolidated with its first (in)direct non-CFI parent company[8]. If such an entity has a foreign parent company, it will be classified in subsector S.127 (in accordance with par 2.23). This decision tree ultimately determines if an entity will be classified in subsector S.127 Captive financial institutions and money lenders.

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[8] It is not desirable that an artificial subsidiary which has a direct CFI parent is classified in subsector S.127.