Sveriges Riksbank 2006-07-14
Statistiska Centralbyrån

Dear Bill,

See below our comments to the issue of sector classification of various kinds of controlling companies and some other classification issue regarding financial assets and liabilities. This letter is sent as a follow-up to the latest CMFB-discussion on item A.9.2 on June 30 2006, and is copied to Helena Figueira at Eurostat and Reimund Mink at ECB.

Defining and classification of Holding companies and other controlling companies

The document to item 9.2 "Financial Assets, Financial Services and Financial Intermediation in the new SNA" discusses the treatment of Holding Companies (HC). The present SNA distinguishes two types of Parent corporations:

A. those with a significant production of their own which acquire control over corporations to strengthen their own position as producers,
B. companies controlling and directing a group of subsidiaries – without having significant production of its own (HC)

Parent companies of type (A) above would be treated according to its main activity with regard to production of goods or services – but not treated according to its activity of controlling a group. For type (B) of Parent Companies the discussion is still ongoing. However, it is proposed to treat them as financial intermediaries, implying an important change compared to SNA93 where these companies are treated according to the main activity of the companies owned. We have problems with this proposal and would propose a less far-reaching change.

In our opinion holding corporations generally do not comply with the requirements of financial enterprises which in SNA 93 are defined as "enterprises that are principally engaged in financial intermediation or in auxililiary financial activities which are closely related to financial intermediation" (SNA, 4.79). If the case when all holding corporations will be treated as "other financial intermediaries" the concept "financial intermediation" needs an overhaul and a revised definition has to be elaborated
It is also of importance to keep the link of financial enterprises between SNA and ISIC as expressed in SNA 4.79 "Financial enterprises consist of all those enterprises (….) whose principal activity is classified under Divisions 65, 66 and 67 of the International Standard Industrial Classification of All Economic Activities (ISIC) Rev.3"

The new ISIC distinguishes between two types of Holding Companies; One group is companies that hold assets(owning controlling levels of equity) of a group of subsidiaries that and whose principal activity is to own the group. ISIC also recognizes Head Offices, performing activity of managing a group. Taking into account the classification made in ISIC, there are three types of parent or holding companies all holding controlling levels of equity).

C. Companies engaged in significant production (below; Parent companies)
D. Companies engaged in managing a daughter company or a group of companies (below; Head Offices)
E. Companies that are engaged in controlling and owning but not directing or managing the group (below; Holding Companies)

By combining ISIC and SNA classification a suitable solution could be found. However, it is important that the two classifications are aligned and that it should be possible to adjust also the new ISIC classification. It seems odd that, as described in the document, Head Offices would be classified as non-financial companies, irrespective of the activity of the group, if the ISIC classification is taken up in the revised SNA.

See below a table summarizing our proposal for the sector classification of various kinds of controlling companies.

First, it is obvious that neither Parents Companies nor Head Offices are mainly functioning as financial intermediates. Instead, they are engaged in own production (parent companies) or managing controlled enterprises (Head Offices) and should be classified according to this (see below).

For Holding Companies, the situation is a bit more complex. For Holding Companies that controls enterprises abroad, their function seem to more like a financial intermediary. One example is that of “capital in transition” as experienced by Luxemburg representing a case where Holding Companies are controlled from abroad and in turn controlling other corporations abroad. Also domestically owned Holding Companies that control companies abroad, seem to act, from the viewpoint of describing and analyzing the domestic economy, as financial intermediaries. Therefore we would propose to treat Holding Companies that control mainly non-resident companies as Other Financial Intermediaries. There is also a practical argument for this: It might be hard to trace the main activity of the group abroad in order to classify the domestic Holding Company.

On the other hand, the situation is different for Holding Companies controlling domestic enterprises. On example is inward Direct Investment, in which case setting up a Holding Company is a common practice for different reasons. The holding company often has no other function than owning and controlling the domestic enterprise which is the target for the inward Direct Investment. In this case it is analytically useful to treat the Holding Company according to the main activity of the group it controls. Also for the Financial Accounts this treatment gives the most meaningful output. We fear that the concept of financial intermediation will be severely expanded if Holding companies acting within the domestic non-financial corporations sector would be regarded as financial intermediaries and moved to the OFI sector.

Table: Sector classification of various kinds of controlling companies

	Companies controlling domestic corporations	**Companies controlling corporations abroad**
Parent companies	Classified according to main activity of its production	Classified according to main activity of its production
Head Offices	Classified according to main activity of the group controlled	Classified according to main activity of the group controlled
Holding Companies	Classified according to main activity of the group controlled	Classified as Other Financial Intermediary

In our view the treatment of holding corporations needs further attention and our proposals above may serve as an input to this.

Classifying financial assets and liabilities

Concerning the recommended solutions of the proposals on 2.1.3, Financial derivatives we support the proposal to classify “financial derivatives” as a separate category. Any further split of the category “financial derivatives” must be on a voluntary basis in our opinion, as these instruments often are rather complex, consisting of different elements. There would probably be difficulties to unambiguous determine their character and it is doubtful whether the cost of reporting institutions and the statistical producers would be in proportion to the statistical information achieved and its reliability.

If the final outcome after all would be the proposed distinction between options and forwards and also distinguishing employee stock options from other options we would rather prefer a straight hierarchy, as shown below. We would also propose a slightly different naming of the subcategories of Financial Derivatives. The categories “Options” and “Forwards” may give a rather narrow impression of the content of these items. Since instruments like swaps (interest, currency, credit default) and Fras, and many other, should be included here, it would be more accurate to make a breakdown according to Option-like and Forward-like derivatives.

Financial derivatives and employee stock options
- *Option-like*
  - *of which employee stock options*
- *Forward-like*

In our opinion the employee stock options should be on a voluntary basis as their impact can fluctuate over time and between countries and industry.

Concerning the introducing a subcategory “reserves for calls on standardized guaranties” we want to emphasize that this category should be restricted only to guaranties designed as financial contingent assets where the contractual arrangement itself has a market value because it is tradable or can be offset on the market and the category should only comprise guarantees where the counterpart can be identified and at the same time is reporting the guarantee in its balance sheet. This symmetry is important to keep the identity between assets and liabilities in the financial accounts. As a consequence it is important with a uniform treatment over all institutional sectors.

Classifying institutional units by financial corporation sub-sector

We cannot se any advantage of the proposed terminology “Miscellaneous financial institutions” compared to the present one “Other financial intermediaries”, which clearly indicates intermediaries and makes distinguishes between these institutions and auxiliaries.

Best regards,

Gunnar Blomberg Marianne Biljer