EUROPEAN CENTRAL BANK

DIRECTORATE GENERAL STATISTICS

Mr. Robert Edwards
Director
Statistics Department
International Monetary Fund
700 19th Street, N.W.
Washington, DC 20431

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Contact person: R. Mink
Ext: 7639
E-mail: reimund.mink@ecb.int

Dear Rob,

**IMF fourth consultation on the updating of the 1993 SNA**

Thank you very much for the letter sent to the ECB on 5 July 2006. After having prepared our response by commenting on the AEG recommendations made in Frankfurt early this year, we have informed the members of the Statistics Committee (STC) of the European System of Central Banks (ESCB) on the enclosed reply. We intend to do the same for the envisaged consistency review of the recommendations with the deadline by 15 September 2006 and for the draft SNA chapters afterwards.

The ECB supports the review of the current System of National Accounts 1993 (1993 SNA, Rev. 1) and, in parallel, of the Balance of Payments Manual (BPM6). It attaches great importance to this coordinated work and is contributing actively to the ongoing discussions. Early this year, the ECB has hosted the fourth Advisory Expert Group on National Accounts (AEG) meeting, and it will host the forthcoming Balance of Payments Committee (BOPCOM) meeting in October 2006.

As you know, ECB staff members participate in the work of the AEG, the BOPCOM and its technical expert groups. The ECB's Directorate General Statistics contributes to the drafting and review phase of both manuals, the 1993 SNA, Rev.1 and the BPM6. One of the main aims is to secure and even to improve the consistency between these manuals, which will significantly increase the quality and comparability of data collected and compiled in this context.

In terms of the ongoing reviewing projects I would like to mention some of the tasks in which the ECB is currently involved: At the request of the ISWGNA, the ECB carries out a world-wide consultation on the classification and terminology of financial assets; furthermore, substantial progress has been achieved on the accounting treatment of employer pension schemes and further results are expected by the Eurostat/ECB Task Force on government pension schemes; and, finally, the ECB is engaged in the drafting and reviewing of sections on guarantees, financial corporations, monetary unions, and other financial-related matters lying within the ECB's field of competence. In this context, we appreciate very

Kaiserstrasse 29, D-60311 Frankfurt am Main
Postfach 16 03 19, D-60066 Frankfurt am Main
Tel.: +49 69-13 44-0 • Fax: +49 69-13 44-6000
http://www.ecb.int • e-mail: postmaster@ecb.int

financial-related matters lying within the ECB's field of competence. In this context, we appreciate very much the close cooperation between the ISWGNA, the Project manager, the Editor and the ECB's Directorate General Statistics.

As regards the provisional decisions achieved at the fourth AEG meeting in Frankfurt from 30 January to 8 February 2006, the ECB would like to express general support for them. However, we would like to offer comments on the treatment of employer pension schemes and on the sub-sectorisation of the financial corporations sector in the updated SNA. Detailed comments are attached in Annex 1 to this letter. We will copy this response also to Mr. Ivo Havinga in the United Nations Statistics Division.

Once again, I would like to express our appreciation for the ongoing fruitful cooperation between the IMF, the other members of the ISWGNA, and the ECB/ESCB in the SNA review process.

Yours sincerely,

W. Bier

Werner Bier

Deputy Director General Statistics

Encl.: ECB comments on the recommendations made by the AEG at its meeting from 30 January 2006 to 8 February 2006

Cc: a) Members of the Statistics Committee

b) Permanent Representative of the ECB at the IMF

c) Members of the ISWGNA

*Mr. Paul Cheung*
*Director*
*United Nations Statistics Division*
*Two United Nations Plaza*
*Room DC2-1656*
*New York, NY 10017*
*Fax (1 212) 963-9851*

*Ms. Shaida Badiee*
*Director*
*Development Data Group*
*The World Bank*
*1818 H Street, N.W.*
*Room MC2-747*

*Washington, D.C. 20433*
*Fax: (1 202) 522-3645*

*Mr. Enrico Giovannini*
*Director*
*Statistics Directorate*
*Organisation for Economic Cooperation and Development*
*2 Rue André Pascal*
*75755 Paris, Cedex 16*
*France*
*Fax: (33 1) 44 30 63 22*

*Mr. Hervé Carre*
*Director-General*
*Statistical Office of the European Communities*
*European Center*
*P.O. Box 1907*
*Luxembourg*
*Fax: (352-430) 13 30 15*

d) Project manager and Editor

*Mrs. Carol S. Carson*
*Project manager*
*1993 SNA Revision Project*
*c/o International Monetary Fund*

*Mrs. Anne Harrison*
*Editor*
*1993 SNA Revision Project*
*c/o OECD*

e) Website "Comments on 1993 SNA updating issues"

*Mr. Ivo Havinga*
*Chief of the Economic Statistics Branch*
*United Nations Statistics Division*
*Two United Nations Plaza*
*New York, NY 10017*
*sna@un.org*
*Fax (1 212) 963-1374*

## *Annex 1:* ECB comments on the recommendations made by the AEG at its meeting from 30 January to 8 February 2006

The ECB generally supports the recommendations made by the AEG.

However, comments are made on the two following issues:

1. The treatment of employer pension schemes and other defined benefit pension schemes (issue 2) and
2. The classification and terminology of financial corporations in the updated SNA (issue C30).

### 1. The treatment of employer pension schemes and other defined benefit pension schemes (issue 2)

The most difficult discussion of the recent AEG meeting in Frankfurt centred around the question whether obligations of unfunded employer pension schemes should be recorded in the core accounts of the new SNA (as recommended by the IMF Task Force on pensions) or in supplementary tables (as proposed in the Eurostat/ECB paper on *Unfunded employer and social security pension schemes* presented to the CMFB last year and distributed to the AEG as a background paper).

There was strong support within the AEG for the IMF Task Force recommendation to recognise the obligations of all employer pension schemes independently of their funding. Nevertheless, the issues raised by many European countries were taken into consideration, especially the difficulties in drawing the line between unfunded pension schemes for government employees and social security schemes. Therefore, the AEG felt it necessary that the ISWGNA should develop criteria that would distinguish between the different types of schemes. Until such criteria are developed, countries will not include the obligations for pensions of government employees in the core accounts but include them together with the obligations for social security schemes in supplementary accounts as recommended in the CMFB paper.

The UN Statistical Commission Report on the thirty-seventh session (7-10 March 2006) refers also to this issue (http://unstats.un.org/unsd/statcom/doc06/Report-English.pdf). It states that the Statistical Commission "took note of the concerns on the treatment of unfunded government pension schemes and the need for continuing consultations on the recommendation of the Advisory Group on National Accounts on that issue, and expressed its positive outlook on a timely resolution within the existing governance structure of the Working Group."

The issue was also discussed at the third meeting of the OECD Statistics Committee in Paris (12-13 June 2006), where a distance emerged on this point between non-Europeans and Europeans. The Committee recommended seeking a solution which recognises the existence of institutional differences and uses supplementary accounts to deal with such differences. The Committee welcomed the forthcoming Task Force created by Eurostat and the ECB, with the participation of the OECD and other ISWGNA members, to address measurement and conceptual issues. The Committee recommended that the Task Force shall conclude its work by the end of the year. The OECD should inform the Committee about the conclusions of the Task Force via written procedure.

In the meantime, further discussions have been taken place on this subject with the aim to make progress and to formulate principles on how to conceptually treat employer pension schemes in the updated SNA. The following principles may guide the future work on this subject:

(i) All employer pension-related flows and stocks, including pension entitlements, provided by private schemes are recorded in the *core accounts,* even if they are unfunded. In this context a private scheme is any for which the government is not directly responsible. (As noted in (vi), even schemes for which government is responsible are included if they are mainly funded.)

(ii) The updated SNA will include a *supplementary table* on pensions which will become a *standard requirement in the updated* SNA. In this table, all flows and stocks of all pension schemes (autonomous pension funds, segregated non autonomous employer schemes, pension part of social security, etc.) will be shown. This table will thus include details of pension flows and stocks that are recorded in the core accounts *plus* those that are not included in the core accounts also giving a complete view of households' pension "assets".

(iii) It is suggested that this *supplementary table* would be compulsory for European Union member states through ESA regulation.

Concerning government sponsored systems:

(iv) Pension entitlements of unfunded, pay-as-you-go government sponsored systems which provide the basic social safety net type of provision, sometimes referred to as pillar one type provision will be recorded in the *supplementary table* (but not in the core account).

(v) The recommendation of the new SNA regarding the recording of unfunded pension schemes sponsored by *government for all employees (whether private sector employees or government's own employees)* will be flexible. Given the different institutional arrangements in countries, the updated SNA will permit recording only some of these pension entitlements in the *core accounts.* However, it will be a requirement that a set of criteria be provided to explain the distinction between those schemes carried forward to the *core accounts*, possibly where the pension promise is of sufficient strength, and those recorded only in the *supplementary table*. Providing a single set of internationally recognized criteria for this distinction should be on the long-term SNA research agenda.

(vi) Pension entitlements of funded systems sponsored by the government will be recorded in the *core accounts*.

## 2. The classification and terminology of financial corporations in the updated SNA (issue C30, also related to units (issue 25))

The ECB's comments on this issue are twofold:

1. They refer to the concerns expressed by the ESCB's Statistics Committee and already communicated to the ISWGNA related to the recommendation of the AEG to classify *money market or cash funds* (MMFs) with other types of investment funds, whether in S.123 or in a new investment fund sub-sector. Accordingly, a *revised sub-sectorisation of financial corporations* is considered.

2. There is still no clear insight in the treatment of institutional units which are supposed to belong to the financial corporations sector but provide neither financial intermediation nor financial auxiliary services. In this context, the treatment of *holding corporations* and *other SPEs* needs further attention.

### *2.1 Money market funds (MMFs)*

While MMFs obviously have some features in common with bond, equity, real estate, etc. funds, the monetary nature of their liabilities implies that their economic character is significantly different. This should then also be reflected in their classification. After all, the main reason for distinguishing between S.122 and S.123 institutional units is that the former have monetary liabilities while the latter do not. A corresponding proposal was submitted to the ISWGNA for further consideration.

This proposal gives priority to maintain consistency between money and banking statistics and financial accounts. It also implies that the definition of "the banking sector for monetary policy purposes" varies somewhat depending on the monetary aggregates in operation, and this flexibility needs to be reflected in the SNA.

### 2.2 *Financial corporations by sub-sector*

Section D of the 1993 SNA Chapter IV on institutional units and sectors specifies the financial corporations sector and its sub-sectors – the central bank, other depository corporations, other financial intermediaries except insurance corporations and pension funds, financial auxiliaries, and insurance corporations and pension funds. The 1995 ESA has taken up almost the same sub-sectorisation with one main exception, the sub-sector monetary financial institutions (MFIs) for statistical purposes as defined by the ECB, in order to guarantee consistency between the ECB money and banking statistics and the ESA financial accounts as well as other national accounts (such as interest payable and receivable).

A possible approach would be to link the type of the financial corporation with the predominant type of financial assets/liabilities it deals with. The *first grouping* consists of institutions incurring liabilities mainly as components of broad money. These components might be currency and deposits as well as other liquid instruments like money market funds or short-term debt securities issued by these institutions. Such institutions should be classified as monetary financial institutions (the central bank and the commercial monetary financial intermediaries including MMFs).

A *second grouping* refers to investment funds (without MMFs, if they are included into the first grouping) acquiring various types of financial or non-financial assets, while a *third grouping* covers insurance corporations and pension funds, which mainly incur insurance technical provisions and invest in different types of financial assets like debt securities, equity and investment fund shares. A *fourth grouping* comprises miscellaneous financial intermediaries such as securitisation vehicles, parent corporations providing financial services, security and derivative dealers, and financial corporations engaged in lending. These types of financial institutions might have to be specified, described in some detail, and defined as this has already been done in the context of the ESCB's other financial intermediaries except insurance corporations and pension funds (OFI statistics).

The four groupings mentioned above are the institutions that predominantly provide financial intermediation services. The *fifth grouping* covers all financial auxiliaries. Financial intermediaries and financial auxiliaries might have to be distinguished from other institutional units providing neither financial intermediation nor financial auxiliary services, like brass plates, empty shells or (specific) holding corporations. These entities are treated as institutional units if they are resident in an economy different to their parent company. They may have to be reclassified as ancillary units when compiling currency union accounts, if the parent companies are resident in other countries of the currency union.

### 2.3 *Holding corporations*

Holding corporations, if they are not financial intermediaries, belong to this type of other financial institutions. Their description must still be refined in the new SNA because there is some confusion whether the type of activity of the holding itself (paragraph 4.37) or the preponderant type of activity of the group controlled by the holding (paragraph 4.100) determines the sector or sub-sector of the holding.

The paragraphs 4.36 and 4.37 of the 1993 SNA distinguish two types of parent companies [corporations]: (a) companies with a significant production of their own which acquire control over other corporations to strengthen their own position as producers; and (b) companies controlling and directing a group of subsidiaries without having significant production of its own – holding corporations. The activities of both types of companies are deemed to be distinct from the activities of the units which they control.

Following this line of reasoning, a parent company of type (a) would be classified according to its main activity, which might be the production of market goods and non-financial services or the production of financial services, but not the control of the group. Accordingly, such a corporation would be classified either as a non-financial corporation or as a financial corporation. The classification of the parent company of type (b) has to be carried out by convention. According to the new ISIC (ISIC rev 4), these parent companies corporations are subsumed under the ISIC class 6420 (financial and insurance activities) describing their activities as "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".

The AEG recommendation on holding corporations (parent companies of type (b)) is consistent with the new ISIC by classifying them as miscellaneous financial institutions. Otherwise, to classify parent companies of type (a) always as non-financial corporations seems to be too narrow. It would be preferable to classify parent companies of companies carrying out (mainly) non-financial activities as non-financial corporations, but also to classify parent companies of companies carrying out (mainly) financial activities as financial corporations.

A more consistent approach would be to distinguish between

(i) Parent corporations, actively managing their group (covering non-financial corporations carrying out mainly non-financial activities and financial corporations carrying out mainly financial activities); and

(ii) Holding corporations (owning a group) without any financial or non-financial activities, if these are identified as separate institutional units.

The classification of these two types of corporations would be as follows: While parent corporations would be either part of the non-financial corporations sector or of the financial corporations sector, holding corporations would be, by convention, specified as *other financial institutions*.

## *2.4 Proposal for a classification of financial corporations by sub-sector*

Following the discussion above the following breakdown of the financial corporations sector into sub-sectors is suggested. According to the first grouping as described above, all monetary financial institutions could be classified in one sub-sector. There are also good reasons to show separately the *central bank* and the *commercial monetary financial institutions including money market funds* (as issuers of broad money) in two separate sub-sub-sectors.

Insurance is subdivided into life insurance and non-life insurance. Life insurance is provided by insurance corporations and pension funds. While we would like to analyse life insurance separately, this may be difficult to ensure via appropriate sub-sectoring as the institutional units insurance corporations cannot be broken down into a life and a non-life services part. Accordingly, *insurance corporations and pension funds* are classified in a second financial corporation sub-sector, with a further optional breakdown into the two components.

The remaining financial corporations are rather heterogeneous; in the current SNA/ESA, they are sub-divided into the two sub-sectors 'other financial intermediaries' (S.123) and 'financial auxiliaries' (S.124). For the new SNA, it is recommended to include all institutions in one sub-sector *miscellaneous financial corporations*. It covers the investment funds (without MMFs, if included in the first sub-sector), various types of financial intermediaries such as securitisation vehicles, parent corporations providing financial services, security and derivative dealers, and financial corporations engaged in lending, as well as financial auxiliaries and (by convention) some institutions such as holding corporations, brass plates or empty shells.

It is necessary to describe in detail the content of this sub-sector as it would allow, in addition to the separation of *investment funds*, a further breakdown of the *other financial institutions* if needed in future. This specifically refers to the various types of financial intermediaries as they collect funds from lenders and transform, or repackage, them in terms of maturity, scale, risk or the like, in ways which suit the requirements of borrowers. In addition, these financial intermediaries place themselves at risk by this transformation activity. Special attention also needs the description of the institutions such as holding corporations providing no goods or services and performing no financial intermediation. They are usually created to obtain tax or regulatory advantages.

**Table 1: Proposed classification of financial corporations sector by sub-sector *)**

**Financial corporations (S.12)**

1. ***Monetary financial institutions (S.121)***
   - *Central bank (S.1211)*
   - *Commercial monetary financial institutions (including money market funds) (S.1212)*

2. ***Miscellaneous financial corporations (S.122)***
   - *Investment funds (without money market funds) (S.1221)*
   - *Other financial institutions (intermediaries, auxiliaries, and other institutions) (S.1222)*

3. ***Insurance corporations and pension funds (S.123)***
   - *Insurance corporations (S.1231)*
   - *Pension funds (S.1232)*

*) The sector codes used in the table are different to those applied in the 1993 SNA.

The proposal as outlined above and illustrated in Table 1 has the advantage to clearly specify the main groupings of financial intermediaries covered by the three sub-sectors. It would also allow compiling from-whom-to-whom financial accounts and balance sheets based on available monetary and financial data, while not much data are available for the still rather small *miscellaneous financial corporations* sub-sector, except for investment funds.