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Monetary and Financial Statistics: Compilation Guide

Chapter 3. Institutional Units and Sectors



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Chapter 3. Institutional Units and Sectors

Introduction

3.1 The definition of institutional units and their grouping into sectors are covered in the *MFSM*, Chapter 3. The concepts used in this *Guide* follow closely the *System of National Accounts 1993 (1993 SNA)*, the *MFSM*, and the new *Government Finance Statistics Manual 2001 (GFSM 2001)*. In addition, this *Guide* expands on issues that are relevant for compilers of monetary statistics and considers special cases whose classification is not straightforward.

3.2 This *Guide* deals with institutional units in their role as holders of financial assets, and focuses consequently on the classification and sectorization of their accounts in the financial system. The residence of institutional units will determine the foreign/domestic breakdown of assets and liabilities of the financial corporations. Similarly, the grouping of resident institutional units into economic sectors and subsectors will show the financial corporations' claims on and liabilities to the different sectors of the domestic economy.

Institutional Units

An institutional unit is an economic entity capable, in its own rights, of owning assets, incurring liabilities, and engaging in economic activities and in transactions with other entities. MFSM, ¶62

3.3 Institutional units, as holders of financial assets and liabilities, constitute the building block for monetary and financial statistics. They hold financial assets in the form of cash, deposit accounts, securities, investments in mutual funds, life insurance policies, etc. On the other hand, they have liabilities to the financial sector originated in loans received from banks or other financial institutions, trade credits, the issuing of securities, or shares owned by the financial sector, among others.

3.4 The *1993 SNA* lists four main attributes of institutional units: (1) they are entitled to own goods or assets in their own rights, (2) they are able to take economic decisions and engage in economic activities, (3) they are able to incur liabilities on their own behalf, and (4) they have a complete set of accounts, or it would be possible to compile it. Two main types of units may qualify as institutional units: (1) persons or group of persons in the form of households, and (2) legal or social entities whose existence is recognized by law.

Households

3.5 A household may consist of an individual or more than one person. Persons constituting a single household own assets in common, assume liabilities on behalf of the whole household, and make collective decisions on expenditure. Therefore, it is meaningful to treat all the persons constituting a household as a single institutional unit. Special cases of individuals living together that are considered a single household are described in the section on sectorization.

3.6 Economic activities undertaken by households, like production and selling of goods and services, are treated as integral part of the households themselves, unless legal entities are created separated from the household.

Legal or social entities

3.7 The other type of institutional units are legal or social entities that engage in economic activities and transactions in their own rights. Such units are responsible and accountable for the economic decisions or actions they take. The *1993 SNA* identifies four main categories of legal or social entities constituting institutional units: (1) corporations, (2) quasi-corporations, (3) government units, and (4) nonprofit institutions (NPI).

Corporations

3.8 A corporation is a legal entity created for the purpose of producing goods or services for the market that may be a source of profit or other financial gains to its owner(s). It is collectively owned by shareholders who have authority to appoint directors responsible for its general management. The most relevant features of corporations may be summarized as follows: (1) their existence is recognized independently of other institutional units, (2) they are created for the purpose of producing goods and services for sale on the market at economically significant prices, (3) their ownership is vested in the shareholders collectively, (4) they are legally responsible and accountable for their actions, and (5) their control is ultimately exercised by the shareholders collectively. Other legal entities that have specialized functions and produce for the market, like producers' cooperatives, limited liability partnerships, or professional associations, are classified as corporations, too.

3.9 It is common for corporations to own shares in other corporations, establishing interrelationships between them. Although sometimes control of a corporation can be achieved with less than half of the shares, a minimum participation of 50 percent has been established as a practical guideline to determine control. Some of the common forms of interrelationships between corporations are listed below.

- ***Conglomerates*** or group of corporations exist when a parent corporation controls several subsidiaries, some of which may control subsidiaries on their own.
- Conglomerates owning subsidiaries or branches in several countries are called ***multinational corporations***.
- ***Holding corporations*** are corporations that control and direct groups of subsidiaries without having any significant production of their own. Very often, holdings are established in a third country for tax purposes.
- A corporation is a ***subsidiary*** of another one, when the latter controls more than half of the former's voting power or has the right to appoint or remove a majority of its directors.
- A corporation is an ***associate*** of another one, when the latter controls between 10 and 50 percent of the voting power of the former, so it can exercise some influence over the policy and management of the former.

- An **ancillary corporation** is a subsidiary wholly owned by a parent corporation whose activities are confined to providing services to the parent corporation. Ancillaries are treated as integral part of the parent corporation.¹
- **Trusts** are arrangements that provide for legal control of portfolios of assets and liabilities and specify the use of the portfolio holdings and the income generated thereby.
- **Special purpose entities** are created to carry out a single, well defined and specific activity.

Quasi-corporation

3.10 Quasi-corporations are unincorporated enterprises that function as if they were corporations and keep complete sets of accounts. For purposes of sectoring and sub-sectoring, they are treated as institutional units separate from the units to which they legally belong.

Quasi-corporations include the following:

- Unincorporated government enterprises engaged in market production and operating **in a similar way to publicly owned** corporations.
- Unincorporated units operated by households, engaged in market production, and operating **as if they were privately owned** corporations.
- Resident unincorporated operations owned entirely or partly by nonresident units (including joint ventures, branches, offices, agencies, and ancillaries) that engage in significant activity within the country over long or indefinite periods.

MFSM, ¶73, corrected.

Government units

3.11 Government units are legal entities established by political processes that have legislative, judicial, or executive authority over other institutional units within specific areas. Their principal functions are: (1) to provide goods and services to the community as a whole on a nonmarket basis, and (2) to redistribute income and wealth by means of transfer payments. Because government units do not charge economically significant prices,² they finance their activities through taxes or other compulsory transfers from units in other sectors.

3.12 Government units may own unincorporated enterprises engaged in the production of market goods and services. If these enterprises are managed in a way similar to a corporation, with their own set of accounts, they must be treated as a quasi-corporation. If, on the other hand, they do not meet these requirements, they remain part of the parent government unit.

¹ Except for ancillary units established in a foreign territory, as will be seen later when discussing residency.

² For a definition of economically significant prices, see the section on public nonfinancial corporations

Nonprofit institutions

3.13 Nonprofit institutions (NPI) are legal or social entities created for the purpose of producing goods and services whose status does not permit them to be a source of income, profit, or other financial gain for the units that establish, control or finance them.

3.14 Although they may not be a source of profit to other institutional units, NPIs may nevertheless be market producers if they provide services for which they charge economically significant prices or fees. NPIs engaged in market production sell their output at prices that are economically significant, but any surpluses generated by their activities must be retained within the NPI. Market NPIs include all NPIs serving enterprises, except those controlled and mainly financed by government units (which belong to the government sector). NPIs created by business associations to promote their interests (*market NPIs serving business*) are classified as market producers, and their members' contributions are treated as a payment for services.

3.15 Nonmarket NPIs provide most of their output free of charge or at prices that are not economically significant. *NPIs controlled and mainly financed by government* are classified within the general government sector.³ Control by government means that it has the ability to determine the general policy of the unit.

Residency

3.16 The concept and coverage of residence for monetary statistics are identical to those in the 1993 SNA and in the *Balance of Payments Manual*, 5th edition (BPM5). The separation between resident and nonresident units is a fundamental feature for monetary and financial statistics that permits to estimate the external position of the financial sector. The key concept to define the residency of an economic unit is its *center of economic interest*.

An institutional unit is said to have a center of economic interest within a country when there exists some location—dwelling, place of production, or other premises—within the economic territory of the country on, or from, which it engages, and intends to continue to engage, in a significant amount of economic activity. MFSM, ¶54

3.17 Two aspects must be highlighted from the preceding definition: (1) the economic unit must maintain at least one production establishment in the country, (2) it should plan to operate that establishment for at least one year.

3.18 Compilers of monetary statistics must be aware that residency is not based on nationality of the account holder, or on the currency denomination of the account. A common mistake when reporting monetary statistics is to classify foreign-currency-denominated

³ These include also NPIs serving business if they are controlled and mainly financed by government.

accounts as accounts of nonresidents, irrespective of the center of economic interest of the account holders.⁴

Resident units

3.19 An institutional unit is a resident of a country where it has a center of economic interest. In most cases, it is considered a resident if it has already engaged in economic activities and transactions on a significant scale in the country for one year or more, or if it intends to do so. Ownership of land and structures within the country is not a sufficient condition to define a center of economic interest, because the owner can be a resident of another country and have a center of economic interest in the latter.

3.20 Corporations or quasi-corporations are residents of a country if they intend to engage in significant amount of production of goods or services or own land and structures there. They must maintain at least one production establishment in the country and plan to operate it indefinitely or over a long period of time. Additional criteria are the maintenance of a set of accounts covering local productive activities, proof of income taxes paid to the local government, or the existence of a substantial physical presence.

3.21 A household is a resident in the country in which its members maintain regular residence. All individuals who belong to the same household must be residents in the same country.

3.22 Apart from this general definition, there are special cases where individuals or productive units should be considered residents of the country, and their accounts incorporated into the domestic assets and liabilities of the financial corporations.

Cross-border workers

3.23 Individuals who cross international borders to work (some or all of the time) remain residents of their home countries. These include: (1) seasonal workers who work part of the year in another country and then return to their households; (2) border workers who regularly cross the frontier (daily, weekly) to work in a neighboring country.

3.24 However, if these workers engage in substantial and sustained economic activity abroad, earn income, consume, maintain regular residence abroad, and return only briefly or infrequently to their original household, they cease to be considered a member of that household and therefore no longer resident in the country in which the household is resident.

⁴ Often, the error is due to historical circumstances, when in the past only nonresidents could open accounts in foreign currency. As the financial systems liberalized, residents were also given the possibility to open such accounts, but the financial institutions continued reporting all foreign currency accounts as being held by nonresidents.

In this case, these individuals have clearly a center of economic interest where they work and consume.

Staff of international organizations and technical assistance personnel

3.25 Although international organizations are by definition residents of the rest of the world (i.e. nonresidents of the country where their enclaves are located), employees of these organizations are residents of the local economies where they live continuously for more than one year.

3.26 Technical assistance personnel on long-term (i.e., more than one year) assignment should be treated as residents of the countries where they work. Employees of international organizations on long-term assignment in a country different from the one where the organization is located are residents of the country where they perform their duties. If the assignment is shorter than one year, they are considered residents of the economy in which they continuously live.

Locally recruited staff of diplomatic representations

3.27 Locally recruited staff of embassies and other diplomatic representations continue to have their center of economic interest in the country where they live and the embassy (or representation) is located. Therefore, they should be considered residents of their home country.

Crew members of vessels or aircrafts

3.28 Crew members of vessels or aircrafts continue to be residents of the countries where they have their principal residence (even if they are outside the country for long periods of time) and not of the economies in which they are stopping or lying over but not living.

Pension funds of international organizations

3.29 Pension funds of international organizations are treated as residents of the economy in which the organization is located, and are then part of the other financial corporations sector of that economy.

Subsidiaries or branches of multinational conglomerates

3.30 Subsidiaries or branches of multinational corporations should be treated as a separate unit from the parent company, because they have their own balance sheet and retain legal responsibility for their corporate actions, and they are residents of the economy where they operate.

Offshore enterprises and offshore banks

3.31 Offshore units engaged in manufacturing processes (including assembly of components manufactured elsewhere) are residents of the economies in which the offshore enterprises are located. This treatment applies even if the units are located in special zones exempted from custom duties or regulations (free trade zones).

3.32 Similarly, offshore banks are considered residents of the country where they have their offices, and should be part of the other depository corporations sector of the host country, if they issue liabilities included in the national definition of broad money.

Units operating mobile equipment

3.33 Mobile equipment can consist of ships, aircrafts, drilling rigs and platforms, railway rolling stock, etc. The same principles applied to determine the residence of an enterprise must be applied to an enterprise operating mobile equipment outside the economic territory where the enterprise is resident. If the operations take place in international waters or airspace, the unit has a center of economic interest where the operator maintains residence. If the operations take place in another economy, then the unit has a center of economic interest in this economy and is considered a resident there if it has a separate set of accounts and pays taxes where it operates. Otherwise, production is attributed to the original operator and the unit is a resident of the country where the operator resides.

Construction companies

3.34 Construction companies operating in a foreign country (for instance, for the construction of major projects like roads or dams) must normally open a site office in the country where the project is undertaken. Although the site office may have no separate legal identity, it may nevertheless be treated as a quasi-corporation and therefore as a resident of the country where the project is located. This is particular applicable to large scale projects with a completion time of several years.

3.35 If the construction project will be finished in less than a year, it can be assumed that the parent company does not have a center of economic interest there and the construction site can be considered an enclave of the country where the company has its headquarters. Consequently, the accounts of the site office should be recorded as accounts of nonresidents.

Ancillary corporations, holdings, and special purpose entities

3.36 Domestic ancillaries are treated as integral parts of the parent corporation, rather than as separate institutional units. However, ancillary corporations located in a country different from their parent corporations are treated as separate units, and consider residents of the country where they are legally established.

3.37 Holdings and special purpose entities (SPEs) are often constituted outside the country where their parent corporation resides, either for tax purposes, or because of legal or accounting considerations. Even if these holdings and SPEs are bare trustees, not bearing any market or credit risk, they are treated as separate units and consider residents of the economic territory where they are established.

Multiterritory enterprises or entities

3.38 Multiterritory enterprises are single enterprises that have substantial operations in two or more territories, but for which branches are not able to be identified. Particular cases of multiterritory enterprises are binational (or multinational) public entities established to construct and operate hydroelectric projects on river borders, and bridges or tunnels that cross borders. The *BPM5* (§82) indicates that the operations of these corporations may be allocated proportionally to the amounts of financial capital each country has contributed, or that the enterprises may be treated as residents of the country where their headquarters are located and the premises in other countries as branches of a foreign corporation, although specifying that the first method is preferable. For the *BPM5* update (planned for 2008), a consensus is forming to allocate multiterritorial enterprises to the predominant territory, or to split them into separate units, with equity shares and other factors as the basis for prorating.

Nonprofit institutions

3.39 An NPI is a resident of the country under whose laws and regulations it was created, and in which its existence as a legal or social entity is officially recognized and recorded. When an NPI engages in charity or relief work on an international scale, it is necessary to specify the residence of any branches it may maintain in individual countries in dispensing relief. If an NPI maintains a branch or unit for one year or more in a particular country, that branch or unit should be considered a resident of that country.

National offices of regional central banks

3.40 A regional central bank is an international financial institution that acts as a common central bank for the member countries of a currency union. If the structure of the currency union is such that the regional central bank has headquarters in one country and maintains national offices in each member country, these national offices (which act as the central bank for those countries) must be treated as a separate institutional unit from the institution's headquarters and considered residents of the country where they are located.

3.41 If, on the other hand, there are no national central banks, the headquarters office of the regional central bank is not classified as a separate institutional unit, and the stock and flows for the assets and liabilities of the regional central bank are allocated to the individual member countries of the currency union on the basis of each member's claim on the regional central bank

Nonresident units

3.42 Institutional units that have their center of economic interest outside the country are nonresidents and their accounts must be recorded as being part of foreign assets or foreign liabilities, irrespective of the nationality of the account holder and of the currency denomination of the account. In monetary statistics, the most common cases of nonresident accounts are correspondent accounts held in overseas banks, loans due to banks located outside the country, and the accounts of international financial institutions (IMF, World Bank, etc.).

3.43 Aside from the clear-cut cases where it is easy to identify the accounts of nonresidents, there are several instances where the account holder is a nonresident of the economy, even being a national of the country or living in the country.

Migrant workers

3.44 Individuals who earn income, consume, maintain regular residence abroad, and return only briefly or infrequently to their original households are no longer considered part of the household in their home country but residents of the country where they regularly work. Even if an individual continues to be employed and paid by an enterprise that is resident in his or her home country, that person should normally be treated as a resident in the host country if he or she works continuously for one year or more.

3.45 Very often, these individuals maintain deposit accounts in their country of origin for savings purposes or to have access to funds when they visit their country. Because migrant workers are nonresident of their home country, their accounts should be reported as nonresident accounts and therefore as a foreign liability of the depository corporations sector. Conversely, any loan given to a migrant worker in his or her country of origin should be reported as a loan to a nonresident. For banks and other depository institutions it is not easy to identify accounts of migrant workers as nonresident accounts, because they are opened using a national passport and giving a national address. In countries with a substantial proportion of their population working and living abroad, special instructions should be issued to the banks with a view to identifying the accounts of migrant workers.

3.46 If the account opened by a migrant worker is a joint account with a resident of the country, or if the account holder authorizes a resident of the country to withdraw money from such account, then the account should be considered to belong to a resident and be reported under domestic liabilities.

Students and medical patients

3.47 However long they study abroad, students should be treated as residents of their country of origin, as long as they remain members of households in their home countries. The accounts they open in the country where they study should be reported, therefore, as accounts of nonresidents.

3.48 Medical patients staying abroad are also treated as residents of their country of origin, even if they stay over one year, as long as they remain members of households in their home countries.

Foreign diplomatic representations

3.49 Embassies and other diplomatic representations are enclaves of their governments in the host country and part of the economic territory of the represented government. The accounts they hold in the financial system of the host country must be reported as accounts of nonresidents.

3.50 Employees sent by a government to work in its diplomatic representations continue to have a center of economic interest in their home country, irrespective of the length of their assignment in the foreign country. They continue to be residents in their home country, even if they live in dwellings outside the enclaves, and the accounts they hold in the financial system must be classified as accounts of nonresidents.

Military personnel

3.51 Military personnel stationed abroad, in an enclave of their home country (a military base) or in peace-keeping missions, continue to have their center of economic interest in their home economy, irrespective of the length of duty of their assignment. Therefore, they are considered nonresidents of the country where they are serving. This is typical the case of U.N. missions in post-war countries, as well as U.N./NATO military forces.

International organizations and aid agencies

3.52 International organizations are not considered residents of any national economy, including that in which they are located or conduct their affairs. They are treated as extraterritorial, i.e. nonresident, by that economy. Any account these organizations have in the financial system of the country must be treated as a nonresident account. Holdings of securities issued by international organizations should be reported as a separate category under securities issued by nonresidents.

Regional central banks

3.53 The national offices of regional central banks are considered residents of the country where they are located. However, the headquarters office of a regional central bank should be classified as a separate nonresident unit holding its own assets and liabilities. When compiling monetary statistics for the currency union as a whole, the regional central bank is a resident institutional unit of the currency union. Securities issued by a regional central bank should be reported by their holders as securities issued by a nonresident, rather than being allocated to the member countries of the bank.

Sectorization of Institutional Units

Sectorization of domestic institutional units is a key element in the compilation and presentation of monetary and financial statistics. MFSM, ¶180

3.54 An adequate sectorization of the economy is fundamental for a proper compilation and presentation of monetary statistics. An adequate sectorization of monetary and financial accounts allows identifying financial corporations' claims on each of the other resident sectors and is key to constructing financial statistics. The *MFSM* and this *Guide* recommend to compile monetary and financial statistics following a sectorization consistent with the *1993 SNA*, which groups similar kinds of institutional units according to their economic objectives, functions, and behavior.

3.55 In the *1993 SNA* and the *MFSM*, the resident institutional units of the economy are grouped into five mutually exclusive sectors: (1) the financial corporations sector, (2) the nonfinancial corporations sector, (3) the general government, (4) the household sector, and (5) the nonprofit institutions serving households sector. Units engaged in activities belonging to different sectors, which do not have separate set of accounts, must be classified as a whole to one or another sector, depending on the prevailing activity. Some of these sectors are also grouped into subsectors, as shown in Box 3-1.

Box 3.1. Main Sectors and Subsectors of the Economy

Financial corporations

Depository corporations

Central bank

Other depository corporations

Commercial banks

Merchant banks, savings and loans associations, credit unions, rural banks, discount houses, post office giro institutions, offshore banks, etc.

Other financial corporations

Other financial intermediaries

Finance companies, leasing companies, investment banks, mutual funds, underwriters and dealers in securities, pawnshops, special purpose entities, holding corporations, asset management companies, etc.

Insurance corporations and pension funds

Insurance companies

Pension funds

Financial auxiliaries

Public exchanges, brokers, bureaux de change, financial derivative corporations, supervisory agencies, bank restructuring agencies, solicitor nominee companies, trusts, etc.

Nonfinancial corporations

Public nonfinancial corporations

Other nonfinancial corporations

General government

Central government

State government

Local government

Social security funds*

Households

Nonprofit institutions serving households

* Alternatively, social security funds can be allocated to the other subsectors of general government on the basis of the level at which they are organized.

Financial corporations

The financial corporations sector consists of all resident corporations and quasi-corporations principally engaged in financial intermediation or in related auxiliary financial activities. MFSM, ¶182

3.56 Through financial intermediation, these units raise funds by incurring liabilities on their own account to channel these funds to other institutional units by way of lending or otherwise acquiring financial assets. The most common units engaging in financial

intermediation are commercial banks, but they are by far not the only ones, as will be seen later. Some characteristics of financial intermediation include, among others: (1) the assumption of liabilities to raise funds with the purpose of lending, (2) the possibility of transforming the nature of the funds handled in terms of maturity, interest rates, currency denomination, etc., and (3) the absorption of credit and financial risks.

3.57 Sometimes, the distinction between intermediaries and nonintermediaries is a matter of degree, because all economic units are capable, in one way or another, to engage in financial intermediation. The key factors to decide if an institutional unit is part of the financial corporations sector, or not, are the assumption of credit and financial risks, the existence of a separate set of accounts for the financial intermediation activities, and the relevance of the financial services within the total production of goods and services of the unit.

3.58 The following cases **do not belong to the financial corporations sector**, but to other sectors of the economy:

- Corporations or quasi-corporations mainly engaged in the production of nonfinancial services that provide credit directly to their customers, like manufacturers or retailers that provide consumer credit directly to their customers.
- Individuals or households that lend money or buy and sell foreign currency, if they do not have a complete separate set of accounts for their financial activities.

3.59 Within the financial corporations sector, the *MFSM* distinguishes between depository corporations (comprising the central bank and other depository corporations) and other financial corporations.

Depository corporations sector

Central bank

The central bank is the national financial institution (or institutions) that exercises control over key aspects of the financial system and carries out such activities as issuing currency, regulating money supply and credit, managing international reserves, transacting with the IMF, and providing credit to other depository corporations. MFSM, ¶86

3.60 Central banks act often as a banker to government, holding central government deposits and providing credit (overdrafts, advances, purchase of securities) to the central government. In some countries they also accept deposits from or provide credit to nonfinancial corporations (public or private), or households (generally, their own employees).

3.61 Central bank liabilities in the form of currency issued, liabilities to other depository corporations, and deposits from other sectors (except the central government) constitute the monetary base, which supports the expansion of broad money and credit. A few territories (China, P.R.: Hong Kong, Scotland, Northern Ireland) have authorized private banks to issue

currency, fully backed by foreign reserves held with the monetary authorities; such liabilities of the monetary authorities to the private banks are one of the components of the monetary base in these territories.

3.62 Many central banks act as fiscal agent of their central government, or other government affiliated units. Transactions, and financial assets and liabilities, should be attributed to the central bank only when it is the principal obligor. When it acts only as an agent, the transactions or financial positions should be attributed to the unit that is the principal obligor. Key to determine the ultimate obligor is the assumption of financial risks and the reaping of benefits from the transactions.

3.63 Many central banks also regulate and supervise other depository corporations. If these activities are carried on within the structure of the central bank, they are included in the central bank subsector. However, if they are independent of the central bank, they should be classified as financial auxiliaries outside the central bank subsector.

3.64 Different kinds of institutional units may be included in the central bank subsector.

Central banks

3.65 In most countries, central banks are separately identifiable institutions subject to different degrees of government control, and enjoying different degrees of autonomy in the formulation of monetary policy. They receive different names, like central bank, reserve bank, national bank, state bank, etc.

3.66 Apart from their headquarters, central banks have usually branches in other parts of the country. When compiling the central bank balance sheet, the accounts of all the branches must be consolidated with the accounts of the headquarters.

Currency boards

3.67 Currency boards are independent monetary authorities that issue national currency fully backed by foreign reserve assets,⁵ at a fixed exchange rate vis-à-vis some major international currency. A currency board requires an exchange rate fixed to a major currency, automatic convertibility at this fixed exchange rate, and a long-term commitment to the system. Although they engage in only one of the several central banking functions, currency boards are part of the central bank subsector.

3.68 Countries with long standing currency boards are Djibouti, Brunei Darussalam, China, P.R.: Hong Kong, and some countries member of the Eastern Caribbean Central Bank (ECCB). In the 1990's there was renewed interest in the establishment of currency boards as

⁵ In some cases (e.g. Brunei Darussalam), the backing is somewhat less than 100 percent.

a means of fighting inflation, and four eastern European countries (Bosnia and Herzegovina, Bulgaria, Estonia, and Lithuania) introduced currency boards in their economies.

Government-affiliated agencies

3.69 In some countries, government-affiliated units may perform central bank activities, like the issue of currency, coinage, the maintenance of international reserves, the operation of exchange stabilization funds, or transactions with the IMF. When the agencies in question are separate institutional units from the central government, they should be included in the central bank subsector.

3.70 However, if these units remain financially integrated with, and under the direct control and supervision of the government, then they cannot be treated as separate institutional units and any monetary authority functions carried out by the government should be recorded in the general government sector.

Currency unions and regional central banks

3.71 A common currency area comprises more than one economy and has a regional central bank with the authority to issue the legal tender of the area. To belong to this area, an economy must be a member of the regional central bank. Member countries of the currency union share a common currency, as well as a single monetary and foreign exchange policy. Presently, there are two kinds of currency unions (see box 3-2).

3.72 In the first, centralized, model, the currency union has a regional central bank (RCB) owned by the government of the member countries, and the central bank operations in each member country are carried out by branches or agencies of the RCB. This is the case of the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO), the Banque des États de l'Afrique Central (BEAC), and the Eastern Caribbean Central Bank (ECCB). Here, the *MFSM* and this *Guide* recommend to treat the RCB not as a separate institutional unit, but to allocate its stocks and flows to the individual member countries according to each member's claims on and liabilities to the RCB.

Box 3.2. Currency Unions and Regional Central Banks

Centralized model

Banque Centrale des États de l'Afrique de l'Ouest (BCEAO)

Benin, Burkina Fasso, Côte d'Ivoire, Guinea-Bissau, Mali,
Niger, Senegal, Togo

Banque des États de l'Afrique Central (BEAC)

Cameroon, Central African Republic, Chad,
Republic of Congo, Equatorial Guinea, Gabon

Eastern Caribbean Central Bank (ECCB)

Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat,
St. Kitts and Nevis, St. Lucia, St. Vincens and the Grenadines

Decentralized model

European Central Bank (ECB)

Austria, Belgium, Finland, France, Germany, Greece,
Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain

3.73 The second, decentralized, model is the one adopted by the European Union with the creation of the European Central Bank (ECB). Here, the currency union comprises a RCB and national central banks (NCB), which own the RCB and act as the central bank for the country where they are located. The monetary and foreign exchange policies are adopted by the decision making bodies of the RCB, while their implementation (although coordinated by the RCB) is primarily a responsibility of the NCBs. In this case, the *MFSM* and this *Guide* recommend to classify the headquarters office of the RCB as a separate nonresident unit holding its own assets and liabilities, and each NCB as a resident of the country where it is located. National central banks' claims on the RCB headquarters should be recorded as claims on nonresidents.

3.74 In both cases, the currency union will compile monetary statistics for the whole area, with the RCB consolidating the accounts of the headquarters and its national branches or the NCBs, respectively. Foreign assets and liabilities of the RCB will reflect its claims on and liabilities to nonresidents of the currency union. Furthermore, the *MFSM* recommends that the sectoral balance sheets and surveys for countries in a currency union make a two-way distinction in claims on and liabilities to nonresidents: between nonresidents in other union countries and nonresidents outside the currency union. Claims on and liabilities to the headquarters office of the RCB should also be separately identified.

3.75 Data compilation for the individual countries' central banks subsector will differ according to the currency union model. In the *centralized model*, the financial assets and liabilities of the RCB will be allocated among the member countries according to a predetermined formula. In the *decentralized model*, the country's central bank balance sheet will be the NCB's balance sheet, while its foreign assets and liabilities will reflect claims on and liabilities to non-area residents; its claims on and liabilities to other depository corporations will include all ODCs operating in the currency union.

3.76 When compiling the central bank balance sheet in the individual countries of a currency union, a crucial task is to allocate the liability of currency issued among the countries' central banks. The BCEAO and BEAC delegate the issuing of currency to its member countries, and the banknotes can be physically distinguished by country of issuance; hence, each country reports as currency in circulation the currency it has issued less currency in other depository corporations' vaults. In the case of the Euro Area, banknotes are put in circulation by each NCB (although it is not physically possible to identify the issuer) and coins are minted by the national Treasuries. The amount of banknotes in circulation in each country is allocated every month proportionally to the NCB's share in the ECB's capital, after deducting an 8 percent which is allocated to the ECB's balance sheet; while coins in circulation are allocated according to the actual minting.

Other depository corporations

The other depository corporations subsector consists of all resident financial corporations (except the central bank) and quasi-corporations that are mainly engaged in financial intermediation and that issue liabilities included in the national definition of broad money. MFSM, ¶92

3.77 According to the 1993 SNA, financial intermediation is 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. The role of financial intermediaries is to channel funds from lenders to borrowers by intermediating between them.

3.78 The most common form in which financial intermediaries obtain funds is accepting deposits from the public, but it is not the only one. They can also issue bills, bonds, certificates of deposits, other securities, or other instruments. Deposits are included, by definition, in the national measures of broad money. If, because of their liquidity and acceptability, other instruments become close substitute to deposits, they should also be included in the national definition of broad money, and the intermediaries issuing them be classified as part of the other depository corporations sector.

3.79 Commercial banks constitute the bulk of the other depository corporations sector. In the past they were the only institutions authorized to receive deposits, and therefore the only ones covered by the monetary survey. But as a result of recent technical, legal, and financial innovations, other kinds of liabilities of financial corporations have become increasingly transferable and substitute for deposits and being incorporated in the national definition of broad money. Therefore, a comprehensive other depository corporations survey must include not only all commercial banks operating in the country, but also all other deposit-taking institutions.

Commercial banks

3.80 Commercial banks are the most widespread other depository corporations, and normally the only ones that accept transferable deposits. Depending on the country, they

account for about 80 to 100 percent of the deposits and loans of the system, and are regularly covered by the monetary statistics.

3.81 Commercial banks accept and safeguard deposits from the public, then lend the funds to the general public or other borrowers. The bank puts itself at risk when it accepts the deposit by incurring a liability to repay the depositor. Similarly, it acquires a claim on units to whom it lends.

3.82 Banks often have wide latitude in raising funds and in the way they extend credit. They also provide means of payment as well as netting and clearing of checks and payment drafts. The range of activities in which a bank can participate varies widely between countries, according to the local regulations.

Other deposit-taking institutions

3.83 In addition to commercial banks, there is a long array of financial institutions that also receive deposits (generally nontransferable) or issue instruments that are very close substitute of deposits and should be included in the national definition of broad money. These corporations compete for funds with commercial banks in financial markets, even if they are unable, or unwilling, to incur liabilities in the form of transferable deposits.

3.84 These corporations receive different names in different countries, and also according to the principal activity they pursue. As a result of financial innovation, improved technology, and also financial deregulation in many countries, they take deposits that, although not readily transferable by traditional methods, may increasingly be used for payment purposes.

3.85 The list provided in this *Guide* is neither exhaustive nor prescriptive. The compiler of monetary statistics should investigate the nature of the liabilities assumed by these financial corporations to determine whether they should be included in the national definition of broad money or not. Among the corporations and quasi-corporations that may be included in the other depository corporations sector one finds:

- merchant banks,
- savings and loan associations, building societies, mortgage banks,
- credit unions and credit cooperatives,
- rural and agricultural banks,
- discount houses,
- money-market mutual funds,
- travelers' check companies that mainly engage in financial corporation activities,
- post office giro institutions.

3.86 **Merchant banks** specialize in financial activities that facilitate trade and commerce. They deal typically (although not exclusively) in international finance, long term loans to companies, and underwriting. They accept deposits from large clients and usually do not offer banking services to the general public, specializing in dealings with multinational corporations.

Box 3.3. Collection of data

It is considerably easier to collect data from commercial banks than from other deposit-taking institutions. In many countries, the central bank (or the banking supervisory agency) does not have legal authority over non-banking institutions to compel them to report data. Even in cases where such legal authority exists, some of these institutions (e.g. rural banks or credit unions) may lack the technical and human resources needed to comply with the requirements. However, efforts should be made to cover all deposit-taking institutions operating in the country. In deciding the best approach to extend the coverage, the compiling agency must assess the share of the non-bank institutions in the total deposits and loans of the system, and decide on the timeliness of the reporting and the resources devoted to the compilation of the data.

3.87 *Savings and loans associations, building societies, and mortgage banks* specialize in long-term lending to individuals to purchase or remortgage their homes. Traditionally, building societies and savings and loans associations are mutually held, i.e., the depositors and borrowers are members with voting rights and the ability to control the institutions. However, changes in regulations have relaxed the rules governing these corporations: building societies may raise funds on the commercial money markets; and savings and loans associations may be stock-based and even publicly traded, making them look more like a bank than a financial cooperative.

3.88 *Credit unions* are nonprofit financial institutions owned and controlled by their members, who are the only persons that can use their services. To open an account at a credit union, or to receive a loan from it, an individual must first become a member. Like commercial banks, credit unions receive deposits and make loans, but because they are cooperatives, credit unions do not strive for a profit. In some countries they are as closely regulated as commercial banks and other financial institutions. In other countries, however, they do not fall under the control of the central bank or other supervisory agency, and the collection of their data may be difficult.

3.89 *Rural and agricultural banks* are small community banks that provide financial services in rural areas. Due to the economic characteristics of their clients, they tend to specialize in microfinancing of rural activities. Collecting data from rural banks can at times be problematic: (1) in some countries, rural banks are not supervised by the central bank and do not have a legal obligation to report their data; (2) an inadequate communication infrastructure in remote areas of the country may hinder a regular reporting; and (3) they often lack sufficient manpower to comply timely and accurately with the reporting requirements. All these factors should be taken into account when devising a reporting system for rural banks.

3.90 *Discount houses* act on behalf of, or transact nearly exclusively with, other depository corporations. They raise funds primarily from depository corporations to finance

investments in money-market instruments (e.g. government bills, bankers acceptances, certificates of deposits), or they may purchase securities from individual banks and rediscount them with the central bank. If they issue liabilities included in the national definition of broad money, they are part of the ODC sector; otherwise they should be classified within the other financial intermediaries subsector.

3.91 Some *mutual funds* that raise money from the public to invest in short-term, money-market instruments offer their clients the possibility of withdrawing funds from these accounts through checks issued to the order of third parties. Even when these third-party payments are limited by the amount or number of checks that can be written in a certain period of time, these accounts function as close substitutes for deposits and should be included in the national definition of broad money. If only a small proportion of the administered funds are close substitute for deposits, the compiler can either: (1) identify the funds that are substitute for deposits and include them within the other depository corporations subsector, or (2) classify all the accounts of the mutual fund within the other financial corporations sector.

3.92 *Travelers' checks companies* are not typical intermediaries because they sell negotiable instruments that can be used like currency. Travelers' checks have characteristics of both currency and liquid deposits, and are often included in the definition of broad money. Corporations that issue travelers' checks should be included in the other depository corporations sector. If the issuing institution is a bank, it is already included in the other depository corporations sector and its liabilities in form of travelers' checks should be included in the national definition of broad money.

3.93 Post offices of some countries accept transferable and savings deposits, either on their own account or on behalf of third parties, e.g. the Treasury or another financial corporation. Account holders in *post office giro institutions* may make third-party payments through checks written on their accounts, or may withdraw funds from their savings accounts at other post offices of the country or foreign countries participating in the system. If this part of the business of the post office corporation is managed independently from the postal operations and has a separate set of accounts, it should be included in the other depository corporations sector. On the other hand, if the banking operations are not separated from the rest of the operations of the postal corporation, they will be part of the accounts of the nonfinancial corporations sector, but data on deposits received by the post office giro institutions should be collected. If the post office receives the deposits on behalf of the Treasury, it should be classified as part of the nonfinancial corporations sector, and the deposits should be reported by the Treasury as part of broad money as "central government deposit liabilities".

Offshore banks and offshore financial centers

3.94 *Offshore banks* are established in jurisdictions that provide financial and legal advantages (low or no taxation, privacy, less restrictive legal regulations, etc.), and are exempted from regulations normally imposed on onshore institutions, like reserve requirements or foreign exchange restrictions. They engage in different kinds of financial

transactions, including deposit taking and loans denominated in a currency other than that of the country where they are located. However, they are often restricted from taking deposits from individuals who reside in the country where they are located. The main difference between the offshore and the onshore currency markets is that the former separates the currency of denomination from the country of jurisdiction.

3.95 According to the *BPM5* and the *MFSM*, offshore units engaged in trade and financial operations are residents of the economies in which they are located. This *Guide* recommends to collect data on offshore banks and to include them as part of the other depository corporations sector if they issue liabilities included in broad money. If they do not issue such kind of liabilities, then they should be classified as other financial intermediaries. Due to the special characteristics of offshore banks, they should be separately identified within the sector. Because offshore banks are subject to less stringent regulations than onshore financial institutions, it is sometimes difficult for the compiling agency to collect their data. Sometimes, the central bank does not have regulatory powers over the activities of offshore banks, and must negotiate with these institutions the provision of data, or look for a special provision to ensure their reporting.

3.96 *Offshore financial centers* are jurisdictions where the majority of the financial transactions conducted by institutions located there are carried out on behalf of clients who reside in other jurisdictions. Many of the offshore financial centers are islands, but they do not need to be. With their origins due mainly to the restrictive regulatory regimes in industrialized countries in the 1960s and 1970s, offshore financial centers have adapted to the increased competition produced by the liberalization of the financial regulations in advanced economies, and continue to account for a significant volume of global financial flows. Offshore financial centers should compile data from all the institutions operating in their jurisdiction, which should be treated as residents of the individual jurisdiction.

Banks in liquidation

3.97 Due to financial difficulties, some depository corporations may be operating under the control of receivers or regulators. Some may be even technically bankrupt but continue to exist through subsidies or special arrangements, until a formal bankruptcy is declared. In the meantime between such corporations are intervened and the moment they are liquidated, their deposits may be effectively frozen. It is often unclear how long depositors will need to wait to access their deposits, or whether they will eventually be able to recover all or part of their deposits.

3.98 On the other hand, these institutions in liquidation (or receivership) still have claims on different sectors of the economy, which eventually may be transferred to the restructuring agency or being acquired by other financial corporations. Reorganization, sale, or merger of the affected depository corporations may result in all or part of the deposits eventually becoming available to depositors.

3.99 To avoid distorting the monetary statistics while the restructuring process is still ongoing, the *MFSM* and this *Guide* recommend to keep banks in liquidation within the other depository corporations sector as long as they have assets and/or liabilities. In the ODC sectoral balance sheet, their accounts should be presented as memorandum items. Claims of banks in liquidation to the central government and their holdings of government securities should be included together with the claims of the ODC sector on central government. Regarding deposits, and taking into account that they are being restricted for an indeterminate period of time, they should be classified as “restricted” deposits excluded from broad money. Once the assets and liabilities of the corporations in receivership are fully liquidated, their accounts will be excluded from the financial corporations sector.

Other financial corporations

3.100 The *MFSM* recommends a separate identification of other financial corporations (OFCs), which comprise the *1993 SNA* subsectors relating to other financial intermediaries, insurance corporations and pension funds, and financial auxiliaries.

3.101 The relevance of the OFC sector within the financial system varies by country. The relevance of compiling statistics on this sector will be given by the magnitude of their financial assets and of the liabilities they have to other sectors of the economy. In particular, pension funds and insurance corporations can manage a volume of financial assets (and have financial liabilities) that constitute a significant proportion of the financial assets and liabilities of the other depository corporations sector.

3.102 Collecting data on other financial corporations for monetary and financial statistics purposes can become a difficult task. Most of the institutions comprising the OFC sector are regulated by some official agency. However, these agencies are normally not the central bank or the banking supervisory authority, but other ad-hoc supervisory agencies. Therefore, close collaboration between compilers of monetary statistics and the agencies supervising the different OFCs is required.

Other financial intermediaries

The subsector of other financial intermediaries covers a diverse group of units constituting all financial corporations other than depository corporations, insurance corporations, pension funds, and financial auxiliaries. MFSM, ¶99

3.103 Financial corporations included in the other financial intermediaries subsector generally raise funds on financial markets, but not in the form of deposits, and use them to acquire other kinds of financial assets. These intermediaries often specialize in lending to particular types of borrowers and in using specialized financial arrangements. There is a long list of units that can be classified as other financial intermediaries. Some of them are described in the next paragraphs.

3.104 **Finance companies** engage primarily in the extension of credit to nonfinancial corporations and households, competing actively with banks for business. Normally, they are less regulated than the banking sector, and subject to less reporting requirements than commercial banks. They are very active in consumer credit and hire-purchase, credit cards, commercial lending to small businesses, mortgages, economic development credits, bankers' acceptances, or trade receivables, among others.

3.105 **Captive finance companies** are subsidiaries of other companies that act as financial agents to their parent corporation, raising funds that will be lent to their parents, or which will be used to purchase the parent's receivables. Captive finance companies are sometimes operated by other depository corporations in order to engage in specialized lines of activity or for regulatory reasons. If they are not separate units from their parent corporation, they should be incorporated into the balance sheet of the latter in the corresponding subsector (e.g. other depository corporations). However, if they are separate institutional units, this *Guide* recommends classifying them in the subsector of other financial intermediaries.

3.106 **Financial leasing companies** engage in financing the purchase of tangible assets. The leasing company is the legal owner of the financed goods (airplanes, automobiles, mainframe computers, etc.), but ownership is effectively conveyed to the lessee, who incurs all benefits, costs, and risks associated with ownership of the assets.

3.107 **Investment banks** assist corporations in raising funds in the public market through equity and debt; and provide strategic advisory services for mergers, acquisitions, and other types of financial transactions. They raise money for corporations from the stock markets or using derivatives. Investment banks can also invest their own money directly into a company, project, etc. as a direct investment for which they carry the full risk. Other forms of raising money are through individual investors (private equity), a hedge fund dedicated to making direct investments in corporations (venture capital), or through collateralized loans.

3.108 **Mutual funds** (also called investment pools, investment trusts, unit trusts, or institutions for collective investment) are specially organized financial arrangements that consolidate investor funds for the purpose of acquiring financial assets. Investors usually purchase shares representing fixed proportions of the fund. The liquidity of mutual funds can vary considerably, from very liquid investments in short-term instruments to long-term investments in mortgages and real estate. The breakdown may be relevant for monetary analysis, because there may be a high degree of substitutability between investments in pools and investments in monetary and quasi-monetary instruments. Shares issued by mutual funds may be close substitute of deposits, even allowing to transfer money from these accounts. In that case, the liabilities of these funds should be included in broad money, and the institutions classified within the other depository corporations subsector.

3.109 **Underwriters and dealers in securities** specialize in security market transactions. They may operate either on public exchanges or through privately negotiated deals. They assist firms in issuing new securities through the underwriting and market

placement of new security issues, and/or trade in new or outstanding securities on their own account. Only underwriters and dealers that act as financial intermediaries are classified in this category. Security brokers and other units that arrange trades between security buyers and sellers but do not purchase and hold securities on their own account are classified as financial auxiliaries.

3.110 ***Financial derivative intermediaries*** consist of units that engage primarily in issuing or taking positions in financial derivatives recognized as financial assets.

3.111 ***Specialized financial intermediaries*** consist of a very diverse group of highly specialized intermediaries like: (1) electronic currency corporations, which are primarily involved in issuing electronic currency or similar electronic payments mechanism; (2) export/import finance firms, which handle the broad range of financial and documentary services associated with international trade; (3) factors or factoring companies, which take control of receivables from commercial companies, extend credit by rediscounting the receivables, or provide guarantees that cover late or defaulted payments; (4) hedge funds, which invest in derivative financial instruments, take short positions in securities, or sell over-the-counter derivative contracts; (5) mezzanine companies, which provide short-term financing in merger and corporate takeover situations; (6) venture capital and development capital firms, which pool funds in order to make equity investments in new companies or in companies that are developing new technologies; (7) pawnshops, which offer loans to individuals receiving personal property as collateral.

3.112 ***Special purpose entities (SPE)***, also called special purpose vehicles, are financial entities created to hold securitized assets or assets that have been removed from the balance sheets of corporations or government units. SPE can be separate corporations, but they are often organized as trusts, or as vehicles that are created solely to hold a specific portfolio of assets or liabilities. Securitization of assets on a massive scale has been one of the most important financial innovations and has led to extensive use of SPE as the specific instrument that makes securitization possible. When deciding to classify a SPE within the other financial intermediaries subsector, or within the subsector to which the parent unit belongs, it is essential to establish whether the SPE sells a new financial asset and bears risks, or whether it is simply a trust that passively holds assets. If the SPE is the legal owner of a portfolio of assets, sells a new financial asset that represents an interest in the portfolio, and has a full set of accounts, then the SPE is acting as a financial intermediary and must be classified in the OFC subsector. On the other hand, if the SPE does not effectively transform or intermediate the portfolio and does not bear market or credit risks, then it would be considered a trust that passively holds assets, not deemed to be a separate financial institution from its parent company, and be absorbed into the accounts of its parent company. When the SPEs belong to other depository corporations (or to other financial corporations), their financial statements should be incorporated into the balance sheets—and the reporting—of their parent corporations. Accounts held by SPEs at financial institutions should be classified in the same sector as their parent units, if the SPEs are not separate corporations. SPEs established overseas are treated as separate units from their parent units and classified as other financial intermediaries of the country where they reside.

3.113 ***Holding corporations*** are corporations that control a group of subsidiary corporations and whose principal activity is to own and direct the group. Holding corporations are classified in the OFC sector if the main type of activity of the group of corporations as a whole is financial. When not enough information about the relative size of the subsidiaries is available, a holding corporation may be classified as financial if a simple majority of the corporations it controls is financial. Financial holding corporations may be allocated to subsectors according to the type of financial activity mainly carried out by the group it controls. Therefore, a holding controlling a group of insurance companies will be classified in the subsector of insurance corporations and pension funds. However, if there is no single type of financial activity which is clearly predominant within the group, the holding corporation should be classified in the other financial intermediaries subsector.

3.114 ***Asset management companies*** (AMC) are created to address the problem of non-performing loans (NPL) through the acquisition, management, and disposal of impaired bank assets. Most AMCs have been established by governments as public institutions, but there are also AMCs created by banks as subsidiaries, in order to better manage their own NPL portfolio. AMCs could function as fast disposal instruments selling loans and related assets, medium-term corporate restructuring agencies, warehouses that hold the NPLs for an extended period of time, or hybrids of the three. AMCs are either directly funded by the government or by some form of borrowings, mainly the issuing of bonds with or without government guarantees.⁶ Irrespective of the source of funding, if AMCs are independent institutions, they should be classified as OFC. If they are subsidiaries of ODCs, their balance sheets should be consolidated with the balance sheet of the parent corporation.

Insurance corporations and pension funds

This subsector includes resident insurance corporations and quasi-corporations and autonomous pension funds. MFSM, ¶97

3.115 Both are likely to have large asset bases—held in order to provide benefits to their clients—and also substantial contingent liabilities.

Insurance corporations

3.116 Insurance corporations provide financial benefits to clients and survivors in the event of accidents, illness, death, disasters, or various business or personal costs. The sector includes the central business operations of insurance companies, as well as individual brokers, agents, examiners, and claims adjusters. The sector also includes reinsurance companies, which provide insurance protection to other insurance companies against losses they may sustain.

⁶ These bonds are normally issued to the transferring bank, but the Korean AMC (KAMCO) has also issued bonds traded in the national market as well as in international markets.

3.117 Although a conceptual difference can be drawn between life and nonlife insurance policies, compilers should use their discretion as to whether this distinction is meaningful in their countries. Life insurance corporations invest premiums to build up a portfolio of financial assets to be used against future claims. Nonlife insurance companies provide financial benefits in the event of accidents, fire, property loss, health related expenses, etc., spreading current risk or expenses among clients, rather than building investment portfolios. Companies may sell both life and nonlife insurance, in which case they are called composite insurance companies.

3.118 Many businesses create separately organized insurance subsidiaries (“captives”) to handle their insurance needs. Captives are units separate from their parents and are classified in the OFC subsector. Captives collect premiums from their parent, then reinsure themselves or invest their assets to build up reserves against future claims by the parent. Some captives also handle insurance for unaffiliated units.

3.119 Reinsurance companies accept a portion of the policies written by other insurance corporations in exchange for the premium income on those policies. The reinsurance market is dominated by a small number of very large companies, although there are a wide range of smaller reinsurers. Insurance corporations purchase reinsurance to spread risk and cap the net losses they may incur in case the insured event occurs.

Pension funds

3.120 Pension funds are established for purposes of providing retirement benefits for specific groups of employees. They hold and invest assets of contributors in order to cover future payments. Pensions can be arranged by individuals, social organizations, or through bilateral contracts between employees and their employers. Governments can organize pension plans for their employees that are independent of the social security system. Pension plans can be voluntary, or they can be statelily mandated, with compulsory contributions from the employee and employer. Many pension funds are organized as trusts, in which case the trusts are not considered separate institutional units.

3.121 According to how the benefits are determined, retirement plans may be classified as *defined benefit* or *defined contribution* plans. With a *defined benefit* scheme, the future retirement benefits are determined by some actuarial formula normally related to participants’ length of service and salary, expected retirement ages, mortality rates, etc. With *defined contribution* schemes, the benefits to be received by any individual participant will be established by the individual’s contributions to the fund.

3.122 Pension schemes may be *funded* or *unfunded*. *Funded* plans have separate pools of assets or reserves assigned for the payment of the benefits. *Unfunded* plans are operated by the employer without assigning specific accounts or otherwise creating special reserves for the payment of benefits.

3.123 There are three types of funded pension schemes: (1) those operated by insurance enterprises, (2) those operated as autonomous pension funds, and (3) those operated as nonautonomous pension funds. All three kinds of pension funds hold reserves dedicated to the payment of pensions and other retirement benefits to the employees or other beneficiaries.

3.124 The pension funds included in the OFC subsector are those independently constituted from the units that have created them, and that have their own, separate, assets and liabilities, with specified obligations towards their contributors.

3.125 Not included in the OFC subsector are nonautonomous pension funds managed by the employer, state sponsored pension systems funded through wage taxes (pay-as-you-go schemes), arrangements organized by nongovernment employers and for which the reserves of the fund are simply added to that employer's own reserves or invested in securities issued by that employer. All the assets, liabilities, transactions, and other events of nonautonomous pensions funds are combined with the accounts of the employer operating the scheme and classified in the same institutional sector as the employer. Social security funds, although a pension fund, are not part of the OFC but of the government sector. Also not included in the OFC subsector are tax favored individual retirement plans that supplement other pension schemes, like IRAs and 401k plans in the United States.

Financial auxiliaries

<p><i>The financial auxiliary subsector includes financial corporations that engage in activities closely related to financial intermediation but do not act as intermediaries. MFSM, ¶101</i></p>
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3.126 Activities that are auxiliary to intermediation may be performed, on a secondary basis, by traditional financial intermediaries or by separate, specialized financial auxiliaries that do not, as a main business activity, raise funds or extend credit on their own account. The subdivision presented in this *Guide* shows the most common designations for financial corporations classified as financial auxiliaries.

3.127 ***Public exchanges and securities markets*** are institutions that provide a location and facilities where commodities and securities (bonds, equities, financial derivatives, etc.) are transacted. An exchange is often responsible for ensuring the qualifications of its members, guaranteeing the completion of transactions, clearing and netting transactions, arranging payments, resolving disputes, and insuring or providing capital to guard against fraud or other losses. The sector includes the exchange itself and a number of services related to securities transactions, such as securities depository companies, accounting and clearing offices, and other specialized service companies related to securities, as well as nongovernmental organizations that regulate or supervise exchanges and securities markets. Compilers are advised to classify markets as organized exchanges if they (1) are legally determined to be exchanges by regulators or courts; (2) hold accounts or deposits for clients in their own name or act as counterparties in trades; (3) maintain insurance or capital

reserves; (4) exercise control over the trading membership; (5) operate a margining system or collect collateral; or (6) have a highly specific location and physical facilities.

3.128 **Brokers and agents** are individuals or firms that arrange, execute, or otherwise facilitate client transactions in financial assets. Included here are brokers and agents handling the purchase and sale of securities or other financial contracts for their clients, and financial advisory services to brokers and their clients. Many brokerage firms also trade in financial securities or financial derivatives on their own account, making it difficult to distinguish the brokers and agents from the underwriter and dealers classified as financial intermediaries. Only brokers and agents that clearly specialize in brokerage and related activities, not taking own financial risks, should be included in this subsector.

3.129 **Foreign exchange companies, or bureaux de change** are units that buy and sell foreign exchange in retail or wholesale markets. In many countries, foreign exchange corporations are licensed and regulated and good data on their activities can be collected. In economies with foreign exchange controls, firms (e.g. travel agencies) or individuals engage in informal foreign exchange trade, complicating the measurement of the activity. Most commercial banks have departments trading in foreign exchange, and the activity is incorporated into the balance sheet of the banks.

3.130 **Financial guarantee corporations** insure customers against financial loss on specific contracts and securities, or against the collapse of financial institutions. Guarantors must establish financial capability for fulfilling potential obligations but, unlike insurance corporations, do not have a definable pool of assets constituting insurance technical reserves, may not be regulated as insurance corporations, and may be limited to specific types of financial transactions. Very often, guarantees on financial instruments are provided by banks, securities brokers, and other financial intermediaries as a secondary related activity. Only specialized independent companies should be classified within this subsector, and the guaranteeing activity of other financial intermediaries should be classified in the subsector of the primary business. It is not always easy to distinguish between financial guarantee corporations and insurance corporations, and in borderline cases these units should be classified as insurance corporations.

3.131 **Insurance and pension auxiliaries** include agents, adjusters, and salvage administrators. Their unique nature and, in some countries, the large scale of their activity justify the separate identification of these units.

3.132 **Financial derivative corporations** facilitate the issuing of contracts in financial derivatives, without actually issuing the financial derivatives or taking financial positions in them. Although these units may have financial claims and liabilities associated with their derivatives positions, they are not classified as financial intermediaries because they are not involved in an intermediation process or incurring liabilities in order to acquire financial assets. These financial derivative corporations should be distinguished from financial derivative intermediaries that issue or take positions in financial derivatives, and which are classified as financial intermediaries.

3.133 **Representative offices of foreign banks** that do not accept deposits or extend credits should be classified as a resident financial auxiliary, even though they promote and facilitate transactions of the nonresident parent company.

3.134 **Corporations primarily involved in operations of electronic payment mechanisms**, but that do not incur liabilities against the instruments, should be included in the subsector of financial auxiliaries if they can be separately identified as institutional units and are primarily involved in this specialized activity. If, on the other hand, they are part of a parent corporation engaged in banking, other financial intermediation, or other activity (e.g. computer networks), they are classified in the subsector of the parent company. If they hold liabilities against issues of electronic currency, then they are part of the other financial intermediaries subsector.

3.135 **Supervisory agencies and regulatory bodies** that regulate or supervise financial corporations are classified in this subsector if they are independent units, even if they are agencies affiliated with the government. The recommendation of the *MFSM* and this *Guide* differs from the recommendation of the *1993 SNA*, which classifies them as part of the central bank subsector if they are separate institutional units, or as part of the general government if they cannot be treated as separate institutional units. The *MFSM* follows the treatment proposed in the *European System of Accounts (ESA)* on the basis that these regulatory bodies are not intermediaries, and that the activities of some units (e.g. securities commissioners or insurance regulators) have little relationship to typical central bank activities. When the regulatory activities over banks and other financial corporations are exercised by the central bank through one of its departments, then such regulatory activity is often included within the accounts of the central bank. Relevant for financial statistics is the case when these regulatory bodies become involved in extending emergency credits, or acquiring assets and liabilities of financial institutions during bankruptcies or reorganizations. When holdings of financial assets and liabilities become substantial, the unit should probably be reclassified as a financial intermediary or into the central bank subsector, or the central government sector, depending on its primary activity.

3.136 **Bank restructuring agencies** are set up as independent entities with the aim of reviewing the rehabilitation plans of suspended finance corporations, assisting depositors and creditors of suspended finance corporations, administering the liquidation of nonviable finance corporations, or overseeing their liquidation process.

3.137 **Solicitor nominee companies** are bare trustees that receive funds from private lenders to lend them directly to borrowers on the security of real property. The nominee company holds the security for each loan in its own name, but on behalf of the contributors to the loan, who are the beneficial owners of the security. Because the nominee company is a bare trustee, no guarantee is given to the lenders that the borrower will pay interest or principal on due date.

3.138 **Trusts** are arrangements that provide for legal control of portfolios of assets and liabilities and specify the use of the portfolio holdings and the income generated thereby.

Because compilers rarely have access to detailed information on all but the largest trusts, sectorization of trusts is difficult and may have to be based on practical considerations. In general, trusts will not be recognized as separate institutional units and will be consolidated with the units that control or benefit from them. Data on trusts administered by depository corporations should be reported together with the accounts of the parent corporations. On the other hand, trusts used for some types of financial intermediation (securitization, collateralized security issuance, investment pooling) may be recognized as separate units if (1) they act like financial intermediaries, (2) no other unit can reasonably be considered as controlling the portfolio, and (3) serious discrepancies can occur in the financial accounts if these financial trusts are ignored. Similarly, trusts organized in foreign countries may be treated as a separate institutional unit, resident of the country where it has its legal domicile.

Nonfinancial corporations

The nonfinancial corporations sector encompasses [resident] corporations and quasi-corporations engaging primarily in the production of market goods and nonfinancial services. MFSM, ¶106

3.139 The nonfinancial corporations sector is composed of the following set of resident institutional units: (1) all resident nonfinancial corporations, irrespective of the residence of their shareholders; (2) all resident nonfinancial quasi-corporations, including the branches or agencies of foreign-owned nonfinancial enterprises that are engaged in significant amount of production on the economic territory on a long-term basis; and (3) all resident non-profit institutions that are market producers of goods or nonfinancial services.

3.140 Some nonfinancial corporations may have secondary financial activities, like producers or retailers of goods that provide consumer credit directly to their customers. Such corporations are classified as belonging entirely to the nonfinancial corporations sector, provided their main activity is nonfinancial.

The nonfinancial corporations sector is divided, on the basis of the types of institutional units exercising control, into two mutually exclusive subsectors. Public nonfinancial corporations ... [and] other nonfinancial corporations. MFSM, ¶106

Public nonfinancial corporations

3.141 Public nonfinancial corporations consist of resident nonfinancial corporations and quasi-corporations that are subject to control by government units. Control over a corporation is defined as the ability to determine general corporate policy by choosing appropriate directors, if necessary.

3.142 The government may secure control over a corporation: (1) by owning more than half of the voting shares or otherwise controlling more than half of the shareholders' voting power; or (2) as a result of special legislation, decree or regulation empowering the

government to determine corporate policy or to appoint the directors. Control of more than half of the shareholders' voting power can be exercised directly via ownership of the shares, or indirectly through another public corporation that have a controlling power over a subsidiary.

3.143 To be classified as a public nonfinancial corporation, rather than as a government agency, a corporation must produce goods or nonfinancial services for the market and charge for them economically significant prices. Economically significant prices are prices that influence the demand for the good or service in question. The prices charged for the goods or services may be insufficient to generate a profit for the corporation or even to cover its production cost; but as long as they are high enough to influence the demand, the institutional unit must be classified as a public corporation. For instance, many railroad and urban transportation public enterprises generate losses, but the fare they charge for their service is high enough to produce a sizable income to the corporation and to influence the decision of the public to use or not the system. On the other hand, some government services (e.g. national parks) charge a nominal fee that is so low that it does not discourage use of the facilities nor produce enough income to finance the operations.

3.144 For a unit that sell its output to be classified as a public nonfinancial corporation, it must charge for its products or services economically significant prices, and it must sell most of its output to the public. For instance, a government publishing office dedicated solely to the printing business, which sells its publications at prices that produce enough income to cover all or most of the costs of its operation, should be classified as a public nonfinancial corporation. However, a national statistical office will be considered part of the central government, even if its publications are sold to the general public, because this is not its core activity and produces only a marginal income that should be classified as special revenue.

3.145 If a unit is an internal service organization that sells its output mainly to other government units, such as a transportation pool, a supply depot, or an ammunitions factory, then it is treated as an ancillary and its activities are consolidated with the other activities of the government unit that controls it. If a unit is established by the government to borrow on the market and to lend only to general government units (even on commercial terms), this unit should be classified as part of the general government, although it has all the characteristics of a financial corporation.⁷

3.146 In order for a public corporation (or quasi-corporation) to exist, the government must allow considerable discretion with respect to the management of the production process and the use of the funds. The corporation must be able to maintain its own working capital and be able to finance some or all of its capital formation, either from its own resources or by borrowing. The ability to distinguish flows of income and capital

⁷ However, if the unit lends to public corporations, then it would be classified as a financial corporation.

between a corporation and the government unit that owns it implies that the operating and financing activities of the corporation are not fully integrated with the parent's corresponding activities, despite the fact that the corporation is not a separate legal entity.

3.147 It is often difficult for compilers of monetary statistics to distinguish between the accounts of public and private nonfinancial corporations, and of units belonging to the general government or to the public nonfinancial corporations sector. The trouble intensified after the wave of privatization of public corporations that occurred during the 1980s and 1990s. Without a firm reference, compilers at central banks and other depository corporations use their own knowledge—not always right and up-to-date—when classifying a unit in one or another sector. Mistakes are common, and partially privatized corporations (still under government control) are classified as private corporations, fully privatized corporations are still reported as public nonfinancial corporations, or government agencies are misclassified as public nonfinancial corporations. The starting point to cope with this problem should be the production of a unique, official, comprehensive list of institutional units belonging to the public nonfinancial corporations sector. This list should be distributed to the central bank, other depository corporations and other financial corporations to guarantee a uniform sectorization of these units. The list should be periodically reviewed and updated. Some countries went a step further and introduced an identification code (normally linked to the tax system) for each economic unit, which automatically classifies the unit in its corresponding sector.

Other nonfinancial corporations

3.148 Within the subgroup of other nonfinancial corporations, a distinction can be made between: (1) national private nonfinancial corporations and (2) foreign-controlled nonfinancial corporations.

3.149 ***National private nonfinancial corporations*** include all resident nonfinancial corporations that are not controlled by government or by nonresident institutional units. Effective control is difficult to determine in a corporation that has minority ownership shares, but a practical rule is to assign control to the group that owns more than 50 percent of the shares of the corporation.

3.150 Private nonfinancial corporations are created for the purpose of obtaining a profit or other financial gain. The key to classifying a unit in this subgroup is the characteristic of producing for the market and the motive of profit or other financial gain to the owners. Therefore, private nonfinancial corporations may generate losses during certain periods of time, although if the losses are systematic and extended, it is expected that the corporation will eventually go bankrupt and disappear.

3.151 Some private nonfinancial corporations may produce goods or services for the government, or public goods or public services, or goods or services for the market that are (highly) subsidized by the government. Even if these goods and services cannot be

considered as being produced for the market, the corporations producing them are profit-oriented and should be classified as private nonfinancial corporations.

3.152 This subsector also includes NPIs producing goods or nonfinancial services for the market, such as institutions engaged in providing education or health services on a fee-paying basis, or trade associations serving enterprises.

3.153 ***Foreign controlled nonfinancial corporations*** comprise all resident nonfinancial corporations that are controlled by nonresident institutional units. The classification is based on majority control (more than 50 percent of the shares), and is therefore not identical with the balance of payments concept of direct investment enterprises, which includes associated firms (those with 10-50 percent ownership by nonresidents). This subsector includes: (1) all subsidiaries (but not associates) of nonresident corporations; (2) all corporations controlled by a nonresident institutional unit that is not itself a corporation, like a corporation controlled by a foreign government, or by a group of nonresident units acting in concert; and (3) all branches or other unincorporated agencies that are engaged in significant amounts of production on the economic territory on a long-term basis and that are, therefore, treated as resident quasi-corporations.

Special cases

Household unincorporated market enterprises

3.154 Household unincorporated market enterprises are created to produce goods or services for sale or barter on the market. They can engage in virtually any kind of productive activity, and can range from single persons working as street traders or shoe cleaners with virtually no capital or premises of their own, through manufacturing, construction, or service enterprises with several employees. These enterprises also include unincorporated partnerships with partners belonging to different households.

3.155 If these unincorporated enterprises have their own set of accounts, independent from the households and their owners do not bear unlimited liability for the debts of the business, then they can be treated as quasi-corporations and classified in the nonfinancial corporations sector. Otherwise, they should be classified as part of the household sector.

Special purpose entities

3.156 Special purpose entities are classified within the other financial intermediaries subsector when they actively manage their portfolio of assets, place themselves at financial risk, and have a full set of accounts. Very often, however, SPEs are created simply for accounting purposes, in order to take off-balance sheet some operations of the parent corporation. These SPEs are created with legal arrangements that heavily restrict the decision capacity of their governing board (autopilot arrangements), and all the risks and profits of their operations are transferred to the parent corporation.

3.157 The new international financial accounting standards recommend that the consolidated statements of the parent corporation include the statements of all SPEs in which the corporation has a controlling financial interest. This approach takes into account the economic substance of the relationship parent corporation/SPE, rather than merely their legal form, considering the SPE not as an independent unit, but solely as an ancillary of the parent corporation. Consistent with this approach, this *Guide* recommends that the accounts held by such SPEs at financial corporations be reported as belonging to the economic sector of their parent corporations, rather than as accounts of OFCs.

3.158 When SPEs are established in an economic territory other than the country of the parent company, they should be considered resident of the host economy, even if they have little or no physical presence there. In these cases, they should be treated as separate autonomous resident institutional units, and the accounts they hold in the financial sector of the host economy must be reported correspondingly as accounts of OFCs.

General government

<p><i>General government units exercise legislative, judicial, or executive authority over other institutional units within a specified area. MFSM, ¶108</i></p>
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3.159 Government units are unique kinds of legal entities established by political processes. Typically, governments provide to the community, for collective consumption, free goods and services such as public administration, defense, and law enforcement. These public goods are: (1) non-excludable, i.e. once created, it is not possible to prevent people from gaining access to the goods; and (2) non-rival, i.e. each person can benefit from them without diminishing anyone else's access to the good. Because of these characteristics, their provision has to be organized collectively and financed through taxation or other income. Additionally, governments may also provide goods or services free, or at prices that are not economically significant, to individual households, even though individuals could be charged for the consumption of such goods and services. Finally, governments may pay transfers to other institutional units, mostly households, in order to redistribute income or wealth. Governments have authority to raise funds by collecting taxes or compulsory transfers from other institutional units, and are also able to borrow funds on their own account.

3.160 A government unit is not limited in its geographic location, as a ministry or a department may be deliberately dispersed throughout the country, or it may maintain branch offices or agencies in different locations. Notwithstanding their separate location, these offices are part of the same institutional unit.

3.161 There may, however, be government entities with a separate legal identity and substantial autonomy, including direction over the volume and composition of their expenditures and a direct source of revenue, such as earmarked taxes. These entities should be treated as separate government units if they maintain full sets of accounts, own goods or assets in their own right, engage in nonmarket activities for which they are held accountable at law, and are able to incur liabilities and enter into contracts.

3.162 The general government sector consists of all government units and all nonmarket NPIs controlled and mainly financed by the government. Depending on the administrative and legal arrangements, there may be more than one level of government within a country, and not all countries have all levels of government. The *1993 SNA* and the *2001 GFSM* provide two primary methods of constructing subsectors of the general government. The first divide the general government into: (1) central government, (2) state governments, (3) local governments, and (4) social security funds. The second method includes social security funds in the subsectors of general government in which they operate (i.e. central, state, local). The choice between one or other method will depend on the magnitude and organization of social security funds, as well as to the extent to which they are managed independently of the government units with which they are associated.

Central government

3.163 The political authority of central government extends over the entire territory of the country. The central government has the authority to impose taxes on all resident and nonresident units engaged in economic activities within the country. The central government is responsible for providing collective services for the benefit of the community as a whole, such as national defense, relations with other countries, public order and safety, and the efficient operation of the social and economic system of the country. In addition, it may incur expenses on the provision of services primarily for the benefit of the individual households, such as education or health, and it may make transfers to other institutional units, including other levels of government.

3.164 The central government is a large and complex subsector in most countries. It is generally composed of a central group of departments or ministries, plus autonomous units under the authority of the central government. The departments (or ministries) are sometimes deliberately dispersed throughout the country, but they nevertheless remain part of the central government. Similarly, if the central government maintains branch offices or agencies in different parts of the country to meet local needs, including military bases or installations that serve national defense purposes, these must also be counted as constituting a single institutional unit within the central government. Compilers of monetary statistics should therefore classify the accounts of central government agencies to the corresponding institutional unit, irrespective of the geographical location of the office or agency. For instance, the Ministry of Health may maintain a network of hospitals in different parts of the country, whose accounts must be classified as belonging to the central government, rather than to a local governmental agency.

3.165 In some countries, the central government may include units that engage in financial transactions performed in other countries by central banks. Units of the central government may be responsible for the issuance of currency, the maintenance of international reserves, the operation of exchange stabilization funds, or transactions with the International Monetary Fund (IMF). When the units in question remain financially integrated with the central government and under the direct control and supervision of the central government, they cannot be treated as separate institutional units. Moreover, whatever

monetary authority functions are carried out by the central government, they are recorded in the government sector and not the financial sector. However, because of the analytical importance attached to obtaining accounts covering the monetary authorities as a whole, and in order to provide links with other statistical systems, it is recommended that the transactions of central government agencies carrying out monetary authority and deposit-taking functions should be separately identified, so that they may be combined with those of the central bank and other depository corporations.

3.166 From the point of view of a compiler of monetary statistics, several categories within the central government sector can be highlighted, in order to ensure a proper classification of their accounts. Here, like in the already mentioned case of public nonfinancial corporations, it is of the utmost importance that compilers be provided with a unique, comprehensive, list of institutional units belonging to the central government (as well as to other government levels). To ensure consistency, the responsibility for producing and updating this list should rest on one agency (perhaps under the aegis of the Ministry of Finance or the General Accounting Office). The list should be periodically reviewed, but stability in the definition of each level of the public sector should be granted, to avoid switching institutional units back and forth between different government levels. Also, caution should be used when reclassifying units within, into, or out of the public sector.

Government branches

3.167 The most extensive number of central government bodies comprises the executive, legislative, and judicial powers. Included here are the office of the presidency, all national ministries, secretaries, armed forces, parliament, and all offices of the national judicial system. As was already stated, if some of these institutions have branches dispersed throughout the country, their accounts should be classified as part of the accounts of the corresponding institutional unit within the central government.

3.168 Some institutions, like health or education ministries, maintain establishments for the provision of services to the general public (hospitals, schools, universities), which are offered for free, or charging fees that are not economically significant. The accounts of these establishments should be reported together with the accounts of the parent ministry as central government accounts.

3.169 On the other hand, if such establishments charge economically significant prices for their services, earning an income that substantially finance their operations, are managed autonomously, own assets and incur liabilities on their own rights, they may be considered to be market NPIs and their accounts incorporated within the public nonfinancial corporations subsector.

Nonmarket NPIs

3.170 Nonmarket NPIs controlled and mainly financed by the central government, although legally nongovernment units, should be classified as part of the central government

sector. Governments may choose to use NPIs rather than government agencies to carry out certain government policies because NPIs may be seen as detached, objective, and not subject to political pressures. There is a long list of government NPIs, such as research and development institutes, standard setting agencies, environmental protection agencies, etc.

3.171 Government control over a nonmarket NPI is determined by the ability to influence the NPI's general policy or programs, to appoint its directors and/or managers, and the amount of financing received from the central government. An NPI mainly financed by a central government unit through the national budget should be considered a central government agency, even if it charges fees for its services or may have an extraordinary source of income through the sale of its products. For instance, it is common that standard setting agencies charge for the issuing of certificates of quality, or that research and development institutes copyright and sell their discoveries, but these fees are not their main source of income and the institutions continue to rely heavily on government transfers to finance their budgets.

Autonomous agencies

3.172 Within the central government there are numerous units created for special purposes, which enjoy substantial administrative autonomy in terms of policy setting and budget management, but which should be nonetheless classified as part of the central government because they are mainly funded through the national budget.

3.173 *Special agencies* may have a separate legal identity and discretion over the volume and composition of their expenditure, and they may also have a direct source of revenue in the form of earmarked taxes. Such agencies are often established to carry out specific functions like road construction or the nonmarket production of health or education services.

3.174 *Agencies that manage international financed development projects.* International development projects, like the ones financed by multilateral organizations (e.g. World Bank) or donor agencies (e.g. U.S.AID), require normally the setting of a managing agency with power to hire staff, acquire goods, and contract work for the implementation of the project. These managing agencies are also requested to open special accounts, either at the central bank or at commercial banks, to administer the project funds. Although these agencies enjoy autonomy and their expenditures must be strictly project related, they must be nonetheless considered part of the central government,⁸ because it is the central government (normally the Ministry of Finance) who negotiates the loans or grants with the international organizations and who assumes the financial liability of the project.⁹ For analytical purposes,

⁸ In some cases, the loans or grants are extended to a subnational level of government, or to a financial institution that acts as the central government fiscal agent. In these cases, the accounts should be classified within the corresponding sector (state or local government, or financial corporations).

⁹ Moreover, the central government retains the authority to cancel the project at any time.

however, it may be necessary to identify separately the government accounts related to international financed projects.

3.175 *National universities* are a special case of units providing education services. Even if they are incorporated into the Ministry of Education and receive most of their funding through the national budget, they normally enjoy a much greater degree of policy and financial autonomy than primary or secondary schools. Because of this greater autonomy, some compilers tend to report deposit accounts of universities as not being part of central government deposits. As long as the universities are controlled by a central government unit¹⁰ (e.g., the Ministry of Education) and their main source of funding stems from the central government, their accounts should be part of the central government accounts, even if the universities can dispose freely of such funds once transferred to their accounts.

3.176 *Political parties* are normally part of the NPISH sector. However, in single-party states the relationship between the central government and the government party is so close that the party should be classified within the central government subsector.

Special purpose entities

3.177 Special purpose entities (SPE)¹¹ are created through the transfer of assets, liabilities, or rights to carry out a well-specified activity or series of transactions directly related to the specific purpose for which they were formed. SPEs are being normally created to securitize assets, pooling financial assets owned by the parent corporation and issuing securities backed by those assets.

3.178 Another kind of SPE arrangements used by governments (in partnership with the private sector) to raise financing for the construction and operation of fixed assets take the form of Public-Private-Partnerships (PPP) and Build-Operate-Transfer (BOT) schemes.¹² Under PPP, contractors pay for the construction costs of a public facility (roads, schools, hospitals, prisons, etc.) and then rent the finished project back to the public sector. In a BOT, a private entity receives a franchise from the public sector to finance, design, construct, and operate a facility for a specified period, after which ownership is transferred back to the public sector.

¹⁰ If they are controlled by a state government unit, they are part of the state government subsector.

¹¹ Other names given to these units are vehicle companies, special purpose vehicles, financial vehicle corporations, special purpose units, etc.

¹² Some countries use the term build-own-operate-transfer (BOOT). There is a wide spectrum of schemes similar to the BOT, like build-transfer, build-own-operate, build-lease-transfer, build-transfer-operate, contract-add-operate, design-build-finance-operate, develop-operate-transfer, rehabilitate-operate-transfer, rehabilitate-own-operate, etc.

3.179 In the case of a SPE created to securitize financial assets owned by the government, the question regarding the sectorization of such SPE should go farther than simply whether it is legally a separate institutional unit with a full set of accounts. On the one hand, if the SPE is the legal owner of a portfolio of assets, sells a new financial instrument that represents an interest in the portfolio, and bears credit and commercial risks, then this SPE owned by the government should be classified as a public financial intermediary within the other financial intermediaries subsector. On the other hand, if the SPE has a very limited autonomy, the government guarantees its loans (eliminating market and/or credit risk), and the SPE does not effectively transform or intermediate the portfolio, then the SPE can be considered an ancillary to the government unit controlling it, and its accounts should be classified together with the accounts of the central government.

3.180 In the case of a partnership of the government with the private sector under PPP or BOT schemes, several questions should be raised when deciding where to sectorize their accounts. Due to complex sharing of risks and returns of the assets stipulated in the contracts, it is often not clear which unit is the economic owner of the fixed assets. Additionally, the transfer of legal ownership at the end of the contract at less than market prices implies that some other mechanism within the contract enables the private enterprise to earn a market rate of return. While structured financial arrangements within PPPs provide sometimes for the private sector to take on the responsibility of financing and management, the government often bears substantial risks, raising the question whether the PPP (or BOT) is a private nonfinancial corporation, or simply a government agency disguised as an independent unit.

3.181 Relevant for compilers of monetary statistics is the proper sectorization of the deposit accounts held by SPEs, PPPs, or BOTs in the financial sector, and of the loans extended to these entities. For this task, the nature of the economic relationship between the government and the private sector should be carefully analyzed, going beyond the legal arrangements.

Box 3.4. An actual example of a government SPE

The central government of country X decided to construct a housing complex and to sell the individual units to the public, and to this end created a SPE to manage the project. This SPE did not assume any economic, financial, or credit risks from the operation of the project, since any losses would be absorbed by the government. Conversely, the government would appropriate any profits resulting from the project.

The project was financed with a loan in foreign currency from the central bank to the SPE, which was channeled through a state-owned bank. The state-owned bank did not bear any commercial or exchange rate risks from the operation, nor received any remuneration. If the SPE sustained commercial losses (or could not collect on the mortgages) and did not pay to the state-owned bank, the central government would assume this bank's debt with the central bank. In fact, it was a financing of the central bank to the central government, using the state-owned bank as a pass-through vehicle.

The balance sheet of the central bank showed a claim on other depository corporations for the amount of the loan. The balance sheet of the state-owned bank showed a liability to the central bank, and a claim on the SPE for exactly the same amount. Because of the administrative arrangements of the project, this claim was properly classified as credit to central government, irrespective of the SPE's legal figure. If the state-owned bank had classified the claim as credit to a nonfinancial public corporation, or to a financial auxiliary, the net credit to government would have been understated.

The creation of the SPE allowed the Ministry of Finance of country X to avoid showing the credit received from the central bank in its fiscal accounts during the years the project was under construction, and until it assumed the debt with the central bank through the issue of a security. At that moment, some years after the project was completed and most of the apartments were already sold, the fiscal accounts recorded (in one single operation) the buying of the housing complex from the SPE and the issuing of the security to pay for it. The monetary accounts, on the other hand, correctly recorded the claims of the banking sector on the central government, at the time the credit was being given.

State, provincial, or regional governments

3.182 A state, province, or region is the largest geographical area into which the country as a whole may be divided for political or administrative purposes. The legislative, judicial, and executive authority of a state government extends over the entire area of an individual state, which usually includes numerous localities, but does not extend over other states. The autonomy, powers, and responsibilities of states vary widely among countries,

depending on their political and historical circumstances. In some countries, individual states and state governments may even not exist.

3.183 A state government usually has the fiscal authority to levy taxes on institutional units that are resident or engage in economic activities in its area of competence. To be recognized as a government unit, the entity must be able to own assets, raise funds, and incur liabilities on its own account, and it must also be entitled to spend or allocate at least some of the taxes or other income that it receives according to its own policies. The entity may, however, receive transfers from the central government that are tied to certain specified purposes. A state government should also be able to appoint its own officers independently of external administrative control. On the other hand, if a regional unit is entirely dependent on funds from the central government, and if the central government also dictates the ways in which those funds are to be spent at the regional level, it should be treated as an agency of the central government rather than as a separate institutional unit.

3.184 The state government subsector consists of state governments that are separate institutional units plus those NPIs that are controlled and mainly financed by state governments. The principal departments and ministries of a state government will constitute a single institutional unit in a manner similar to the core unit of the central government. In addition, there may be agencies operating under the authority of a state government with a separate legal identity and enough autonomy to form additional institutional units. The same considerations already stated for the case of the central government regarding nonmarket NPIs, autonomous agencies, and SPEs apply to the sectorization of these units within the state government subsector or into another sector. Similar to the case of the central government, state governments may own, or control, corporations or have units that engage in market production, in which case the relevant producing units should be treated as quasi-corporations.

3.185 There may also be institutional units whose authority extends over two or more states, but which are responsible to the respective state governments. Such units should also be included in the state government subsector.

Local governments

3.186 The legislative, judicial, and executive authority of local government units is restricted to the smallest geographic areas distinguished for administrative and political purposes. The scope of their authority is generally much less than that of the central or state governments, and such governments may or may not be entitled to levy taxes on institutional units or economic activities taking place in their areas. Common sources of income for local governments are taxes on property and automobiles, and fees charged for the provision of collective services (e.g. trash collection), but they are often heavily dependent on grants and transfers from higher levels of government. In some countries, local governments are able to raise funds issuing bonds. Apart from being entitled to own assets, raise funds, and incur liabilities on their own account, local governments must also have some discretion over their

expenditures and should be able to appoint their own officers independently of external administrative controls.

3.187 Local governments provide a wide range of services to local residents. Some of the most typical functions include: (1) educational establishments to which users' fees are small in relation to the cost of providing the service; (2) hospitals and social welfare establishments, such as kindergartens, nurseries, and welfare homes; (3) public sanitation and related entities, such as water purification systems and plants, refuse collection and disposal agencies, cemeteries, and crematoria; and (4) culture, leisure, and sport facilities, such as theaters, concerts, music halls, museums, art galleries, libraries, parks, and open spaces. Local governments do not need to provide these services directly, but they may subcontract the output with a private corporation.

3.188 The same rules used to classify units operating at the central and state government level apply to the local governments subsector. Units such as municipal theaters, museums, swimming pools, etc. should be treated as quasi-corporations if the goods or services are supplied on a market basis. Units supplying services such as education or health on a nonmarket basis remain an integral part of the local government unit to which they belong.

3.189 Statistics for local governments may cover a wide variety of governmental units, such as counties, municipalities, cities, towns, townships, boroughs, school districts, and water sanitation districts. Often, local government units with different functional responsibilities have authority over the same geographic areas. Also, two or more contiguous local governments may organize a government unit with regional authority that is accountable to the local governments; such units should be included in the local government subsector.

3.190 Government units serving both a state and one or more local governments would be included with the level of government that predominates in their operations and finances. In some countries, more than one level of government exists between the central government and the smallest governmental institutional units at a local level; in such cases, these intermediate levels of government are grouped together with the level of government, either state or local, with which they are most closely associated.

Social security funds

3.191 *Social protection schemes* are systematic government interventions intended to relieve households and individuals of the burden of a defined set of social risks. Typical social risks covered by these schemes are: (1) old age, (2) invalidity, (3) death, (4) sickness and maternity, (5) work injury, or (6) unemployment. The government provides the relief in the form of *social benefits*, which are transfer payments (in cash or in kind) provided in a

collective arrangement.¹³ Social protection schemes cover the community as a whole, or large sections of the community, and generally involve compulsory contributions by employees and/or employers. The terms on which benefits are paid to recipients are determined by the government.

3.192 A social security fund is a particular kind of government unit that is devoted to the operation of one or more social security schemes. Social security funds can be found at all government levels (central, regional, local), but to be considered independent institutional units they must be separately organized from the other activities of the government, hold their assets and liabilities separately, and engage in financial transactions on their own account.

3.193 Depending on the country, social security funds can be very large and play an important role in government policies and the mobilization of financial resources of the entire community. The amounts raised, and paid out, in social security contributions and benefits may be deliberately varied in order to achieve policy objectives that have no direct connection with the concept of social security as a social protection scheme. In some countries, social security funds may become so closely integrated with the other finances of the government as to bring into question whether they should be treated as a separate subsector of the general government.

3.194 To classify a social security fund as a subsector of the general government, as part of a government level, or as a financial corporation, it is crucial to determine the form in which the fund is organized and administered. Because social security benefits can be varied at will by the government as part of its overall economic policy, no liabilities are associated with social security schemes in the GFS system and social security funds are considered part of the general government sector. If they remain separately constituted funds they must be treated as separate institutional units. If, on the contrary, their management is closely integrated with the requirements of the government's economic policy, it becomes difficult to justify treating them as a separate subsector.

3.195 Social security funds have to be distinguished from autonomous pension schemes funded with contributions from the employee and/or employer, with benefits linked to the paid contributions. These schemes, either private or run by the government, should be classified in the other financial corporations sector.

¹³ Insurance policies taken by individuals on their own initiative to cover the same kinds of risks are not social protection schemes, but contracts between households and insurance corporations. Savings arrangements designed to protect against social risks are also outside any social protection scheme.

Households

A household is defined as a small group of persons who share the same living accommodation, pool some or all of their income and wealth, and consume certain types of goods and services (mainly housing and food) collectively. Unattached individuals are also considered households. MFSM, ¶111

3.196 Households often coincide with families, but members of the same household do not necessarily have to belong to the same family as long as there is some sharing of resources and consumption. Households may be of any size and take a wide variety of different forms in different societies or cultures, depending on tradition, religion, education, climate, geography, history, and other socio-economic factors.

3.197 Servants or other paid domestic employees who live on the same premises as their employer do not form part of their employer's household, even though they may be provided with accommodation and meals as remuneration in kind, because they have no claims upon the collective resources of their employer's households.

3.198 Persons living permanently in an institution, or who may be expected to reside in an institution for a very long, or indefinite, period of time are treated as belonging to a single institutional household when they have little or no autonomy of action or decision in economic matters. Some examples of persons belonging to institutional households: (1) members of religious orders living in monasteries, convents, or similar institutions; (2) long-term patients in hospitals, including mental hospitals; (3) prisoners serving long sentences; (4) old persons living permanently in retirement homes.

Households as producers

3.199 Households may engage in any kind of economic activity and not merely consumption. Members of households play a major role in production either by operating their own unincorporated enterprises or by supplying labor to other unincorporated or corporate enterprises by working as employees. When a member of a household owns his or her own enterprise, which is not a corporation or quasi-corporation, that enterprise forms an integral part of the household itself.

3.200 Production within the household sector takes place within enterprises that are directly owned and controlled by members of households, either individually or in partnership with others. Producer units within the household sector are all *unincorporated*, meaning that the producer unit is not a separate legal entity from the household itself. The fixed and other assets used in unincorporated enterprises do not belong to the enterprises but to their owners. Their owners are personally liable, without limit, for any debts or obligations incurred in the course of production.

3.201 The activities of unincorporated enterprises owned by households correspond closely to informal economic activity, which is not identical with hidden or illegal activities. Household unincorporated enterprises may produce for the market or for their own final use.

In the first case, the enterprises are created for the purpose of producing goods or services for sale or barter on the market and may comprise any kind of productive activity. In the second case, the enterprises operate primarily for the purpose of producing goods or services for own final use, like the case of subsistence farmers, households engaged in the construction of their own dwellings, or domestic services produced by employing paid staff.

3.202 Unincorporated enterprises owned by households and engaged in market production are classified in the household sector. If these enterprises can be treated as quasi-corporations, they should be classified in the nonfinancial corporations sector.

Nonprofit institutions serving households

<p><i>The NPISH sector comprises a subset of nonprofit institutions. MFSM, ¶114</i></p>

3.203 The majority of NPIs are likely to be nonmarket producers that provide goods or services to their members, other households, or the community as a whole, either free or at prices (or fees) that are not economically significant. Nonmarket NPIs not controlled and not financed by government units are called NPIs serving households (NPISHs) and constitute a separate sector within the system of national accounts.

3.204 NPISHs are mainly financed from contributions, subscriptions from members, or earnings on holdings of real or financial assets. The NPISHs sector includes the following two main kinds of institutions: (1) trade unions, professional or learned societies, consumers' associations, political parties (except in single party states), churches or religious societies (including those financed by the government), and social, cultural, recreational and sport clubs; and (2) charities, relief and aid organizations financed by voluntary transfers (in cash or in kind) from other institutional units.

3.205 Compilers must be aware of borderline cases or misleading denominations when allocating a unit to the NPISH or the nonfinancial corporations sector. For instance, recreational and sport clubs are classified as NPISHs when they are not-for-profit and organized as a civil associations; but many sport clubs are organized as a private enterprise, even with an owner, and must therefore be classified in the nonfinancial corporations sector. Professional associations present also a borderline case, making it necessary to determine if they are truly NPISHs or if they need to be classified as other nonfinancial corporations because they serve enterprises.

3.206 For purposes of compiling monetary statistics, the *MFSM* and this *Guide* recommend to group together the accounts of households and NPISHs in a category "Other resident sectors".