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Holdings, Head Offices and SPEs: Issues and way forward

Common day

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HOLDINGS, HEAD OFFICES AND SPES

ISSUES AND WAY FORWARD

INTRODUCTION

1. This note regarding the delineation and classification of Head Offices, Holding Companies and Special Purpose Entities (SPEs) is a follow-up of exchanges during the OECD Workshop on the Implementation of the 2008 SNA which took place in Paris on 25-27 October 2011 and of results of a survey launched to better identify the difficulties experienced or envisaged by OECD countries when implementing the 2008 SNA.
2. A need for further clarification of a number of issues was expressed at the OECD Workshop. In particular, some countries presented their experience in allocating head offices, holding companies and Special Purpose Entities (SPEs) to the relevant (sub-)sectors, shared the problems they encountered, and raised questions in relation to the delineation and classification of institutional units within the newly defined (sub-)sectors.
3. In their responses to the OECD survey, a large number of countries also highlighted the difficulties regarding the treatment of the above-mentioned units and the provision of information relating to them, expressed the effects they envisaged due to the creation of the new subsectors within financial corporations (S12) and to the move of SPEs and holding companies from the non-financial corporations' sector (S11) to the financial corporations' sector, and stressed the need for further guidance.
4. As a first follow-up, an issue paper on the classification of head offices, holding corporations and special purpose entities (SPE), prepared by the OECD, was presented at the 7th Meeting of the Advisory Expert Group on National Accounts (AEG), on 23-25 April 2012, in New York and served as a basis for discussions and possible extended work in this area.
5. It was requested that the UNECE Task Force on Global Production and the OECD Working Parties on Financial Statistics and National Accounts analyse the impact of financial innovations and international transactions of SPEs. The IMF would also request its team responsible for the revision of the IMF Monetary and Financial Statistics Manual (MFSM) and its reference group to investigate this issue.
6. This note includes the definitions currently available in the 2008 System of National Accounts (2008 SNA), and in ISIC revision 4, gives a short presentation of the main practices and issues in countries and makes a number of suggestions for dealing with the main issues. Doing so, a distinction is made between (i) the delineation between head offices and holding companies, and (ii) the delineation and classification of SPEs.

HEAD OFFICES AND HOLDING COMPANIES

CURRENT INTERNATIONAL GUIDANCE

1. In the SNA, an institutional unit is an economic entity which is capable of engaging in the full range of transactions in their own right and on their own behalf, that is, among other attributes, is able to exchange the ownership of goods or assets in transactions with other units, to take decisions and engage in economic

activities and to incur liabilities. Two types of institutional units are recognised, persons or group of persons in the form of households, and legal or social entities, such as corporations. The term *corporation* is used for all entities that are legally constituted (SNA 2008, § 4.7). The laws governing their existence vary across countries, but they all have similar typical features that are relevant for the SNA. In particular, they are recognised as separate legal entities from their owners.

2. As stated in § 4.40 of the SNA 2008, the existence, name and address of a corporation are usually recorded in a special register kept for this purpose. However, countries have different practices in registration. In all countries, units that are considered as head offices or as holding companies are classified according to their national or supra-national industrial classification in a class equivalent to respectively ISIC class 7010 and ISIC class 6420. The new SNA 2008 and 2010 ESA establish a very narrow link between their own definitions of head offices and holding companies and the definitions expressed in the ISIC Revision 4 and NACE Revision 2 industry classifications.

3. The activities of a head office defined in section M class 7010 of the ISIC Rev. 4 are as follows:

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

This class excludes activities of holding companies, not engaged in managing (see 6420).

It includes the production of non-financial or financial goods and services depending upon the type of output of its subsidiaries.

4. The holding companies are described in *ISIC Rev. 4* in section K class 6420 as follow:

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

This class excludes active management of companies and enterprises, strategic planning and decision making of the company (see 7010).

This type of unit holds the assets of subsidiary corporations, but it does not undertake any management activities.

5. Whereas no other criteria is specified in ISIC Revision 4, in NACE Revision 2, it is added that units classified in class 6420, and in the other new class 6430 (trusts, funds and similar financial entities), do not have any revenue from the sale of products, and usually do not employ staff (except possibly one or a few persons acting as legal representatives). Sometimes these units are called “brass plates”, or “post boxes” or “empty boxes”, or “special purpose entities - SPE”, as they just have a name and an address. They are numerous in some countries because of tax advantages.

6. While the 1993 SNA did not give explicit guidance for the treatment of head offices, it recommended that holding companies were to be assigned to the institutional sector in which the main activity of the group of subsidiaries was concentrated. Consequently, they were to be classified as financial corporations only when the main activity of the group of corporations they controlled was financial. More precisely, financial holding corporations were to be allocated either to a specific financial subsector according to the type of financial activity carried out by the group it controlled, or to the sub-sector ‘Other financial

intermediary, except insurance corporations and pension funds', if the type of financial activity was not predominant. (SNA 1993, § 4.100)

7. In the 2008 SNA, it is indicated that head offices and holding companies, which are quite different types of units, are both often referred to as holding companies, despite differences. An explicit difference between these two types of unit is that a head office exercises some aspects of managerial control over its subsidiaries and is actively engaged in production (SNA 2008, § 4.53) whereas a holding company holds the assets of subsidiary corporations but does not undertake any management activities (§ 4.54). Moreover, while it is stated that head offices have fewer employees than their subsidiaries and generally at a senior level, and are actively engaged in production, no criteria in terms of employees or the existence of value added, or the importance of financial assets is given for differentiating head offices and holding companies.

8. The 2008 SNA (§ 4.53) recommends that head offices should be allocated to the non-financial corporations' sector (S11) unless all or most of their subsidiaries are financial corporations, in which case they are treated, by convention, as financial auxiliaries and are allocated to subsector S126 of the financial corporations' sector (S12). Head offices of financial corporations that are to be classified in subsector S126 are described in § 4.112 as those that are principally engaged in controlling financial corporations or groups of financial corporations but that do not themselves conduct the business of financial corporations. The 2008 SNA does not give any precision regarding the head offices that are to be allocated to S11.

9. The 2008 SNA (§ 4.54) recommends that holding companies, defined as units that hold the assets of financial corporations, but do not undertake any management activities, should always be allocated to the financial corporations sector, and more precisely to the new sub-sector captive financial institutions and money lenders (S127), even if all the subsidiary corporations are non-financial corporations. In § 4.114, it is specified that the subsector captive financial institutions and money lenders includes holding corporations that hold only the assets (owning controlling-levels of equity) of a group of subsidiary corporations and whose principal activity is owning the group without providing any other service to the enterprises in which the equity is held, that is, they do not administer or manage the units.

10. The Advisory Expert Group (AEG) on National Accounts, which role is to maintain the conceptual basis of the System of National Accounts (SNA) and to provide guidance on issues related to the practical implementation of the SNA concepts with the support of international and regional organisations, met on 23-25 April 2012 in New York. In this context, an issue note regarding the delineation and classification of head offices, holding companies and Special Purpose Entities (SPEs) was presented at the AEG meeting, as a follow-up of the exchanges during the OECD Workshop on the Implementation of the 2008 SNA which took place in Paris on 25-27 October 2011.

11. As main conclusions, the AEG:

- Confirmed the SNA treatment that units can only be classified as head offices or holding corporations when they are institutional units;
- Recommended that a strict definition of holding corporations (in the sense that holding corporations do not provide any management services) should be followed when classifying institutional units as holding corporations to facilitate international comparability and reflect a realistic view of economic activity;
- Agreed that the number of subsidiaries, even if it is only one, is not relevant to classify institutional units as holding corporations;
- Confirmed the SNA treatment that head offices of financial services providers should, by convention, be classified as financial auxiliaries;

PRACTICES AND ISSUES IN COUNTRIES

12. One of the main challenges is the correct identification of head offices and holding companies resulting from the more precise definitions of both entities, and the delineation of passive holders of financial assets (holding companies) from corporations having real economic activity by providing services to other units (head offices). Whereas the term 'holding company' is normally used in respect of companies set up for the sole purpose of holding shares in other companies, which usually tend not to have any business of their own, there is nothing to prevent them from engaging in other activities.

13. As the ISIC code of the entities are chosen by the companies themselves, it may happen that some units classified in the ISIC class 7010 are not head offices and some units classified in the ISIC class 6420 are not holding companies. Moreover, the distinction between the class 7010 (activities of head offices) which includes the overseeing and managing of the related units, the operational control and the day-to-day managing, and the class 7020 (management consultancy activities)¹ which includes corporate strategic and organisational planning, marketing and human resources policies, is not always clear. The same is true for the distinction between the class 6420 (activities of pure holding companies) which only owns assets but does not manage them and the class 6430 (trusts, funds and similar financial entities)² which, as class 6420, does not have any revenue from the sale of products or services, and usually employs no or very few persons.

14. The choice of the class for the registration of a unit in the national business register can also be determined by financial aids or any type of funding granted to selected industrial or service sector, in a specific time, by the country (by law or any other type of regulation).

15. The following box presents a number of corporations of various countries which are named and described as holding companies in their relative websites. It can be noticed that the description of these corporations does not correspond to the SNA definition of pure holding companies and therefore that they should not be classified as holding companies, that is in S127 (Captive financial institutions and money lenders).

¹ This class includes the provision of advice, guidance and operational assistance to businesses and other organisations on management issues, such as strategic and organisational planning; decision areas that are financial in nature; marketing objectives and policies; human resource policies, practices and planning; production scheduling and control planning. This provision of business services may include advice, guidance or operational assistance to businesses and the public service regarding: public relations and communication; lobbying activities; design of accounting methods or procedures, cost accounting programmes, budgetary control procedures; advice and help to businesses and public services in planning, organisation, efficiency and control, management information etc.
This class excludes: design of computer software for accounting systems; legal advice and representation; accounting, bookkeeping and auditing activities, tax consulting; architectural, engineering and other technical advisory activities; advertising activities; market research and public opinion polling; executive placement or search consulting services; educational consulting activities. (<http://unstats.un.org/unsd/cr/registry/iscic-4.asp>)

² This class includes legal entities organised to pool securities or other financial assets, without managing, on behalf of shareholders or beneficiaries. The portfolios are customised to achieve specific investment characteristics, such as diversification, risk, rate of return and price volatility. These entities earn interest, dividends and other property income, but have little or no employment and no revenue from the sale of services.
This class includes: open-end and closed-end investment funds; trusts, estates or agency accounts, administered on behalf of the beneficiaries under the terms of a trust agreement, will or agency agreement; unit investment trust funds
This class excludes: funds and trusts that earn revenue from the sale of goods or services; activities of holding companies; pension funding; management of funds. (<http://unstats.un.org/unsd/cr/registry/iscic-4.asp>)

BOX 1: Cases of holding companies

- **NIPPON TELEGRAPH AND TELEPHONE CORPORATION**, Japanese holding company, has following functions; Corporate Strategy Planning Department, Technology Planning Department, Research and Development Planning Department, Finance and Accounting Department, General Affairs Department including Internal Control Office. Strategic Business Development Division, Global Business Office, Service Innovation Laboratory Group, Information Network Laboratory Group, Science and Core Technology Laboratory Group, Intellectual Property Centre.

- **AREVA SA**, French holding company, has Operational and Corporate Departments as well as Regional Management Organisations. The Operational Departments are responsible for all operations within their scope, worldwide, and or overall performance improvement. The Corporate Departments are responsible for defining policies applying the Group's strategy and for coordinating and contributing to their implementation. The Regional Management Organisations are responsible for safety, the customer relationship, coordination of the local presence.

- **ENI**, Italian holding company, has following functions; Legal Affairs, Corporate Affairs and Governance, Internal Audit, International Relations and Communication, Government Affairs, Research and Technological Innovation, Integrated Risk Management, and Operations.

- **LG CORPORATION**, Korean holding company, has following roles; organising the contribution portfolio in other affiliate companies and ensuring enhancement of products and services through appropriate distribution of resources, vigilant maintenance of performances to enable the best in performance from other affiliate companies and to select the most competent leaders in each field to lead each business division, and evaluating the LG brand and defining the brand identity based on the underlying LG Way principle to ensure top LG brand recognition and acknowledgement by customers.

- **DUPONT**, U.S. holding company has the board of directors, which is responsible for broad corporate policy and overall performance. Board members oversee the management and stewardship of the company and provide input and perspective in evaluating strategic initiatives. They review and, where appropriate, approve fundamental financial and business strategies and major corporate actions, and ensure processes to maintain company's integrity. Board members evaluate and compensate the CEO and monitor succession planning for the CEO and key positions. The Board maintain Environmental Policy, Audit, Compensation, Corporate Governance and Science and Technology Committee.

- **AIR FRANCE KLM**, French and Dutch holding company, has a Group Executive Committee which determines the Group's main orientations within the framework of the strategy approved by the Board of Directors. The Group Executive Committee members fulfil responsibilities at the level of the Air France-KLM Group while retaining their functions within each entity. The Committee meets every two weeks, alternating between Amsterdam and Paris.

- **COPEC**, Chilean holding company in forestry industry, has managers for Legal service, International affairs, Marketing, Administration and Finance, Human Resources, Sales, Operations, Engineering, Accounting, Purchasing, and specific producers.

- **DEUTSCHE BAHN**, German holding company, has directors for Finance and Controlling, Human Resources, Technology and Infrastructure, Compliance, Privacy and Legal Affairs and Corporate Security.

- **BERKSHIRE HATHAWAY Inc**, U.S. holding company, owns subsidiaries that engage in a number of diverse business activities including property and casualty insurance and reinsurance, freight rail transportation, utilities and energy, finance, manufacturing services and retailing. Operation decisions for the various Berkshire businesses are made by managers of the business units. Investment decision and all other capital allocation decision are made for Berkshire and its subsidiaries by the Chairman, in consultation with the Vice Chairman of Berkshire's Board of Directors. Acquisitions of shares of other companies are based on following criteria; large purchases, demonstrated consistent earning power, businesses earning good returns on equity while employing little or no debt, management in place, simple businesses and an offering price. There are only 24 staff members in the corporate office.

16. Looking in some more detail at how countries deal with the identification and classification of head offices and holding companies, in **Austria**, the Central Bank uses, on an ad hoc basis, various sources, of which the business register, containing, among other information, identification of the company, NACE/ISIC classification number, individual balance sheet data, data on turnover and number of employees. There is a common agreement between the Central bank and the Statistical office regarding the concepts and parameters to be used to classify holding companies. The balance sheet equity position in percentage of total balance sheet, the turnover and the number of employees are the main criteria.

17. For Hungary, the question of institutional independence of holding companies should be raised. As they understand, these units should always be allocated to S127 (*Captive financial institutions and money lenders*). However, in the description of the characteristics of a captive financial institution, it is stated that such an entity is not treated as a separate institutional unit and that its accounts are to be consolidated with those of its parent, unless it is resident in another country than that of its parent. The latter part especially refers to SPEs. But for Hungary, the question remains whether the institutional independence test should not also be applied to holding companies.

18. **Israel** has encountered some problems when trying to use the new treatment in its accounts. In particular, the Central Bureau of Statistics found it unclear what level of management control is required to classify a unit as a head office or as a holding company, in particular in the case when the company is responsible for the main business decisions for the entire group and exercises managerial control over the companies of the group. It wonders whether such companies which carry out management function but are not actively engaged in production should be classified as holding companies rather than as head offices.

19. In **Netherlands**, the distinction between head offices and holding companies is not straightforward. Statistics Netherlands will use annual reports of head offices/holding companies to find out whether the definition of these units applies to the business described in the reports and in particular if these entities undertake management activities, like planning and decision-making, and exercise operational control of a group of subsidiaries. Further research is necessary to properly define these units and classify them in the right sub-sector.

20. In **Portugal**, the identification of holding companies, which will move from the non-financial sector (S11) to the financial sector (S12), is the responsibility of the national statistical office. The simplest solution is to use the corporate business register and allocate the relevant units according to the classification in NACE/ISIC. However, as the NACE/ISIC code is selected by the company itself, this may lead to incorrect allocations. To improve the classification of such entities, more detailed information, derived from another source, the IES 2010 (*Informação Empresarial Simplificada/Simplified Business Information*), is used and integrated in the Balance Sheet Database of the Central bank.

21. Following the definitions of 2008 SNA and ESA 2010, the Bank of Portugal has been able to classify holding companies on the basis of specific criteria, such as the number of employee, the level of the financial component in assets, and the quantity of services provided or goods produced. However, the use of different sources and different quantified criteria leads to different results in the classification of holding companies and head offices.

22. In the current compilation system for the financial accounts of **Switzerland**, it is not possible to move holding companies from the non-financial corporations sector to the new sector '*Captive financial institutions and money lenders*' (S127). Indeed, In the Swiss financial accounts, data for the non-financial corporations' sector are based on counterparty information and cross-sector statistics such as the sector classification of bank balance sheets, securities survey statistics as well as data from the balance of payments and the international investment position. One implication of this approach is that data for non-financial corporations are essentially 'domestically consolidated data'. An adaptation of the current

compilation system to accommodate the new requirements of the 2008 SNA regarding holding companies is not feasible and there are currently no plans for a fundamentally new compilation system.

23. **Australia** does not follow the recommendations of 2008 SNA for treatment of holding companies. Basically, holding corporations whose activities are confined to owning the controlling level of equity in the group are not recognised as separate institutional units. The Australian System of National Accounts (ASNA) classifies holding companies in the sector that reflects the major economic activities of the controlled entities or holding company. The major reason why the ASNA departs from the 2008 SNA is that, after extensive user consultation, it was found difficult to interpret the economic meaning of the new SNA treatment.

24. As a result, in Australia holding companies are classified as follows:

- Holding corporations whose activities are confined to owning the controlling levels of equity: they are not considered as separate entities and are classified together with their largest subsidiary. In that case, the holding company can be classified into S11 (non-financial corporations) or into one of the financial subsectors (S122, S123, S124, S125, S126, S128 or S129), except the Captive financial institutions (S127).
- Holding corporations whose principal activity is not only owning equity but also directing the group: they are regarded as separate institutional units. An example of this kind of entities in Australia is a Life Insurance company that issues the quoted shares and directs the group, has subsidiaries which are mainly life insurance entities, but has also non-life insurance entities and financial auxiliaries as subsidiaries. This holding company is classified within the Life Insurance subsector.
- Holding corporations whose principal activity is confined to neither owning nor controlling the group: they are regarded as separate institutional units. An example of this kind of unit in Australia is a bank which issues the quoted shares and directs the group and has subsidiaries engaged in life Insurance, non-life insurance and financial auxiliary as subsidiaries. In this case, the holding company is classified according to the predominant economic activity of the holding company. For the example given, where the holding company is a bank, it is classified within the depository corporation sub-sector of S12.

25. In **Canada**, the structure of enterprises is established through an exercise called 'profiling'. One of the Canadian criteria to separate a head office or holding company from the operating company is the availability of separate financial statements. Head offices are an establishment based entity within the Canadian business register.

26. The need to change or reclassify head offices to S11 or to S126 is triggered by a survey response indicating a change in activity or a profiling exercise which identified the change. If one of the entities in its structure acts like a holding company including the significance of revenue from its funding operations versus the revenue from its production operations, the nature of the assets which it holds, etc., it will be classified as a holding company in the industrial classification. Holding companies which are to be classified in the financial sub-sector S127 are separately identified. Their subsidiaries are classified to the industry from which the majority of their value added is derived.

27. **Mexican** head offices and holding companies, currently classified according to the 2002 version of the North American Industrial Classification System (NAICS), will be classified according to their main activity using the NAICS 2007 and will be assigned respectively to the NAICS class 551111 (Head Offices), which corresponds to the ISIC group 7010, and assigned to the NAICS class 551112 (Holding companies), which corresponds to the ISIC group 6420. The data used for the classification of these units are derived from the Economic Census 2008 since the first moment of the data compilation.

28. The Economic Census and the Mexican Business Directory, in which information regarding holdings of financial groups is reported by the financial supervisor, and through which the economic activity in which units are involved can be identified, match. According to the 2008 SNA, holding companies, which correspond to units that only hold the assets of their subsidiaries, but do not undertake any management activities, will be classified, in theory, as financial corporations, and more precisely to the new 2008 SNA subsector *Captive financial institutions and money lenders* (S127), even if their subsidiary corporations are non-financial corporations. However, the feasibility of such an assignment is still to be checked on the basis of the pertinence and the availability of the data.

29. In the **United States of America** (USA), broadly speaking, the non-financial corporate sector aims to exclude holding companies, which is in line with the 2008 SNA standards. However, they are limited in doing so, as their benchmark source data is mainly obtained from the Tax authorities which rely on a company primary business activity. As a consequence, the classification of holding companies in the subsector S127 is only possible, if the Tax authorities are able to separate holding companies with financial operations from the underlying non-financial activity. When this is not possible, the holding company remains part of the non-financial corporations' sector.

30. Only holding companies that are required to file regulatory reports with supervisors, because they own a thrift (a savings and loan association) or a commercial bank, are included in the US holding company sector and their number is limited. None of the other US financial sectors include holding companies. No other quantitative parameter is used to classify holding companies. All other holding companies, which do not fill a separate tax form, are consolidated with the business of their primary subsidiary and as a consequence are recorded in the non-financial corporate business sector. It is envisaged to review the non-financial corporate tax data with the Internal Revenue Service (IRS) over the next couple of years, to be able to add some of these holding companies to the new SNA subsector S127.

31. In **Korea**, units are classified according to the Korea Standard Industrial Classification (KSIC) which is deeply related to ISIC, CPC (United Nations' Central Product Classification) and HS (Harmonized System, managed by the World Customs Organization). Up to now, head offices are included in the industries that correspond to the primary activities of their subsidiary, since their activities are regarded as ancillary activities in the 1993 SNA. There are still ongoing discussions regarding the allocation of these entities according to 2008 SNA.

32. According to the present system in Korea, holding Companies are classified in the financial corporations' sector if the activities of the major subsidiaries are regarded as those of financial corporations. Otherwise, holding companies are assigned to the non-financial sector in which the main activities of the subsidiaries are included. In order to identify the holding companies that have to be allocated to one or the other sector (S11 or S12), the Fair Trade Commission divides holding companies into two parts, non-financial holding companies and financial holding companies. So, raw data for both types are, every year, obtained from the Commission. Among them, it is envisaged to classify pure holding companies, i.e. those which just play a role of managing subsidiary's equities without any non-financial activities, as captive financial institutions.

SUMMARY AND CONCLUSIONS

33. From a conceptual point of view, the international guidelines, including the further guidance provided by the AEG on National Accounts, seem to be sufficiently clear to distinguish between head offices and holding companies, and to allocate them to the relevant (sub-)sectors. As a start, it has to be established whether or not the unit has the characteristics of a separate institutional unit. Following this, holding companies need to be separated from the head offices. In doing so, the additional AEG-guidance to apply a strict definition of holding companies, in the sense that holding companies do not provide any management related services, is particularly helpful. Finally, holding companies need to be allocated to subsector S127,

independent from whether they have financial or non-financial subsidiaries. On the other hand, head offices have to be allocated to the sector of the primary activities of the subsidiaries.

34. The delineation between head offices and holding companies, which was recommended by the April 2012 AEG meeting, could also be realised by recognising management activities carried out by these entities. The table below lists possible activities to be exercised by these kinds of units. It also proposes some quantitative criteria, with thresholds to be defined after discussion.

QUALITATIVE CRITERIA

Activities	Head offices	Holding companies
Does the unit only own the assets of its subsidiaries and receive dividends?	No	Yes. In that case it is a pure holding company
Is the type of shareholding a familial type (private shareholders) or an institutional type (banks, financial institutions)?	Not relevant	Both possible. In that case it could have an impact of its classification
Does the unit have intra-group contracts with its subsidiary (service provider, such as legal or financial services) and receive fees?	Yes	In principal no, but in real life yes
Is one of the shareholders of the unit also CEO of one of its subsidiaries? In that case, the unit not only holds the assets but also controls the subsidiary. It has a power of decision and vote on the subsidiary.	Yes	No
Is the primary task of the unit to co-ordinate resources and activities, as well as decision-making processes?	Yes, partly	No
Does the unit take remedial actions after evaluating the performance of subsidiaries?	Yes	No
Does the unit establish strategies for the group or for its subsidiaries?	Yes	No
Is the unit engaged in legal affairs and in the compliance of its subsidiaries?	Yes	No
Does the unit conduct internal controls of its subsidiaries?	Yes	No
Does the unit meet the financial needs of its subsidiaries?	Yes	No (except the cases of subscribing shares)
Does the unit manage human resources of the group?	Yes	No
Is the unit engaged in marketing, e.g., by maintaining group's brand?	Yes	No
Is the unit involved in research and development?	Yes (in some cases)	No
Is the number of employees belonging to the unit less than certain numbers? (threshold to be defined)	No	yes
Is the proportion of financial assets in the balance sheet of the unit above certain percentage? (threshold to be defined)	No	yes

35. Information available for units classified in ISIC classes by using the business register covers individual balance sheets (of which financial assets and liabilities) as well as data on turnover and number of employees. To complete the information derived from the business register, some more sources, such as tax returns or other administrative or analytical sources, may be needed to appropriately classify them.

36. However, from a more practical point of view, looking at the difficulties encountered in several countries, it seems obvious that the application of the recommended definitions and treatment for the classification of head offices and holding companies is not that straightforward and may need some further reflection and additional guidance. Moreover, the initial classification has to be controlled at regular intervals to be sure that the allocation of these units corresponds to the real activity of the entities over years.

37. **Head offices**, often, manage several subsidiaries or perform diverse activities. When they registered, they have been classified according to the main activity of their principal subsidiary. Changes in the principal activity may occur which should necessitate a reclassification. It might be envisaged to regularly assess the value added of the various activities and fix criteria (level, stability over time in the change...) before a reclassification is done.

38. **Holding companies**, which have generally been created for fiscal reasons to hold the assets of specific subsidiaries of a corporation (financial or non-financial), may change their principal activity, either at once or gradually over a period of time, either because of seasonal or regional factors, or because of a management decision to vary the pattern of output, or for any other reasons that are not known and are not declared neither by the originator of the entity, nor by the entity itself. By doing so, they often become SPEs, entities created for specific purposes, which, as a consequence, might change their classification in the framework of the 2008 SNA.

39. Among the checks which can be undertaken at regular intervals, a verification of the number of employees, of the change in the level of production of goods or in the provision of services, of the amount of the non-financial assets or the number of subsidiaries could allow to ascertain the correct identification and classification of units and the correct delineation between head offices, holding companies and SPEs. However, while a number of cases call for the classification of the unit to be regularly checked and for a shift over time when necessary, a stability rule has to be established in order to avoid too frequent changes, or unfunded changes, which do not reflect a substantial alteration in the economic reality and which could result in inconsistencies, making the interpretation of the information extremely difficult. That is the reason why harmonised rules have to be defined and decided at the international levels and all countries have to comply with these rules.

SECTOR CLASSIFICATION AND TYPOLOGY OF SPES

40. This section discusses criteria for classifying SPEs in various sectors/subsectors. It also tries to arrive at a typology of different kinds of SPEs.

41. In the 2008 SNA (§ 4.56), SPEs are described as entities having no employees and no non-financial assets, having little physical presence, being related to another corporation, and being often resident in a territory other than the territory of residence of the related corporations. They are commonly managed by employees of another corporation (§ 4.57).

42. The OECD Benchmark Definition of Foreign Direct Investment - 4th Edition (BMD4)³ also discusses the treatment of SPEs. Although there is no universal definition of SPEs, BMD4 describes a number of features shared by SPEs. They are all legal entities that have little or no employment, or operations, or physical presence in the jurisdiction in which they are created by their parent enterprises which are typically located in other jurisdictions (economies). They are often used as devices to raise capital or to

³ <http://www.oecd.org/daf/internationalinvestment/investmentstatisticsandanalysis/40193734.pdf>; also available in French: <http://www.oecd.org/fr/daf/investissementinternational/statistiquesetanalysesdelinvestissement/40632182.pdf>

hold assets and liabilities and usually do not undertake significant production. Also, BMD4 provides several criteria of SPEs (BOX 2).

BOX 2: General criteria to assist compilers to identify SPEs

An enterprise is usually considered as an SPE if it meets the following criteria:

- i)* The enterprise is a legal entity,
 - a)* Formally registered with a national authority; and
 - b)* subject to fiscal and other legal obligations of the economy in which it is resident.
- ii)* The enterprise is ultimately controlled by a non-resident parent, directly or indirectly.
- iii)* The enterprise has no or few employees, little or no production in the host economy and little or no physical presence.
- iv)* Almost all the assets and liabilities of the enterprise represent investments in or from other countries.
- v)* The core business of the enterprise consists of group financing or holding activities, that is – viewed from the perspective of the compiler in a given country – the channeling of funds from non-residents to other non-residents. However, in its daily activities, managing and directing local operations plays only a minor role.

43. In compiling national accounts, SPEs are treated in the same way as any other institutional units by being allocated to sector and industry according to their principal activity unless they fall into one of the following categories, Captive financial institutions, Artificial subsidiaries of corporations, or Special purpose units of general government; see § 4.58 of the 2008 SNA.

44. SPEs regarded as institutional units can be classified as Non-financial corporations (S11), Financial corporations (S12), or General government (S13). If they are regarded as financial corporations, they can be allocated to one of the following financial subsectors: Deposit-taking corporations except the central bank (S122), Money market fund (MMF, S123), Non-MMF investment funds (S124), Other financial intermediaries, except insurance corporations and pension funds (S125), financial auxiliaries (S126), Captive financial institutions and money lenders (S127), or Insurance companies (S128).

45. In the guide “The Impact of Globalization on National Accounts”⁴, jointly drafted by the UNECE, Eurostat and the OECD, and published in January 2012, there is an entire chapter which deals with the statistical treatment of SPEs. The relevant chapter proposes definitions, and describes some of the problems encountered in countries in the recording and the measurement of these types of entities.

INDEPENDENCE OF SPES (Chart 1)

46. National accounts compilers are supposed to make a judgmental decision regarding the independence of an SPE as an institutional unit. An SPE owned by non-residents is treated as an independent institutional unit by convention. When it is owned by residents, an SPE holding assets and liabilities passively usually is not treated as an independent institutional unit, and it is consolidated with the parent.

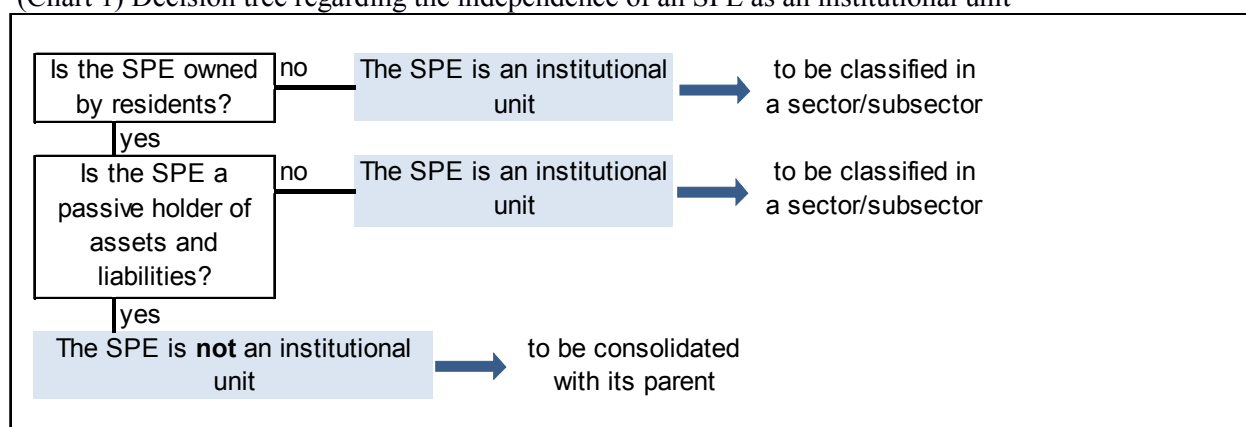
47. Having assets and liability passively is a subjective criterion. In order to make the criteria more concrete, compilers could depend on the number of counterparties with which an SPE carries out its transactions. If an SPE deals only with one entity, the SPE should be considered to be dependent on its counterparty. For example, an SPE is created for transactions, e.g., the liquidation of financial/non-financial assets or fund raising of a financial/non-financial corporation.

⁴ <http://www.unece.org/stat/home/publications-amp-resources/publications/economic-statistics/economic-accounts/2012/guide-on-impact-of-globalization-on-national-accounts/guide-on-impact-of-globalization-on-national-accounts.html>

48. An SPE may transact with its parent on the asset side, and may often have a number of counterparties on the liability side, and vice-versa, when the SPE acts as an agent of the parent which would have to transact in the market itself in the absence of the SPE. Thus, an SPE holding assets and liabilities passively can be translated into an SPE transacting with its parent on either assets or liabilities. Such an SPE should be consolidated to the parent.

49. An SPE which deals with multiple counterparties on both asset and liability sides are regarded as an institutional unit and it is to be classified in a sector/subsector according to the decision tree shown in Chart 2.

(Chart 1) Decision tree regarding the independence of an SPE as an institutional unit

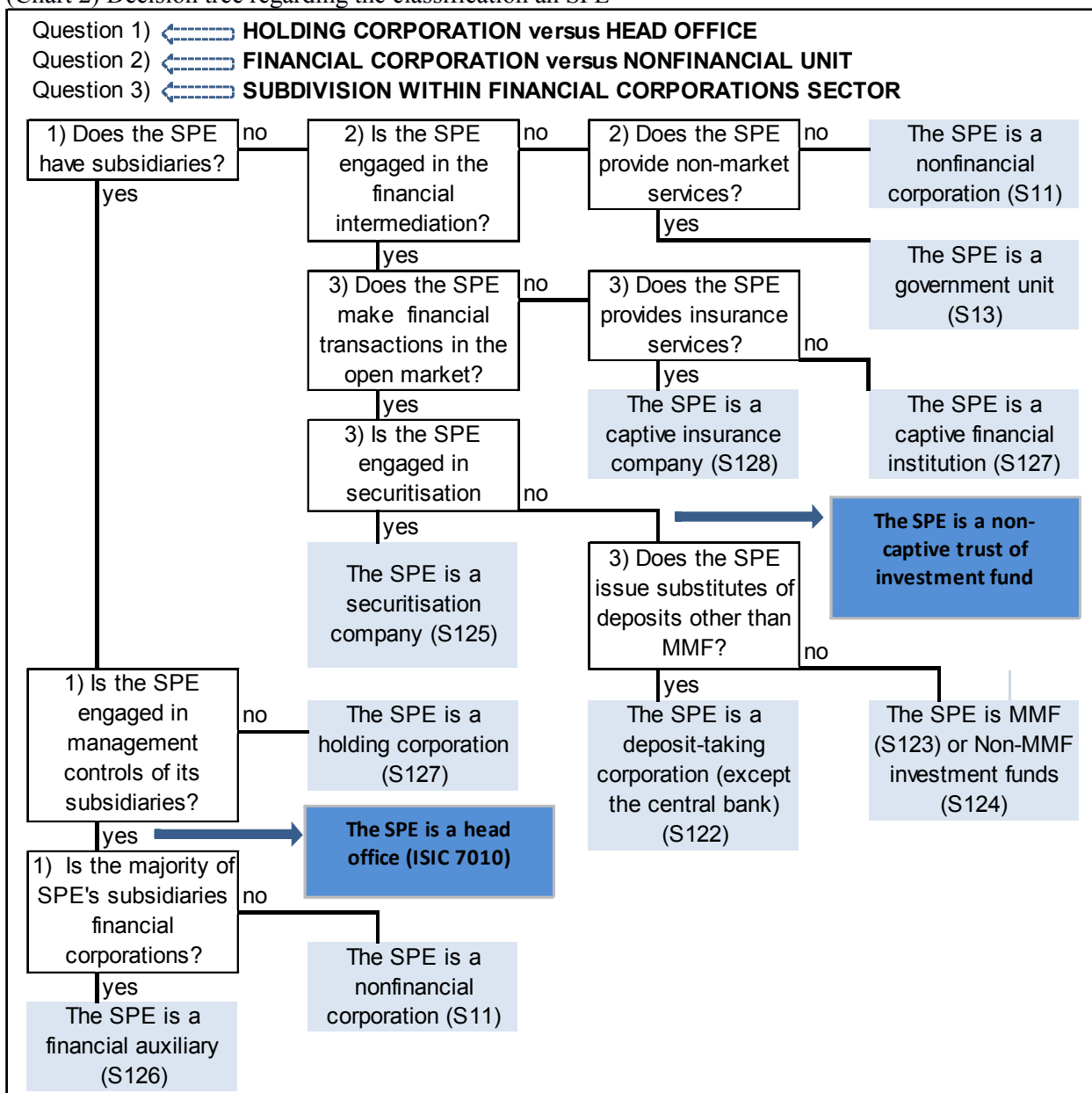


50. According to 2008 SNA, captive financial institutions that cannot act independently of its parent and are simply holders of assets and liabilities (sometimes described as being on auto-pilot), and that are resident in the same economy as their parents, are treated as artificial subsidiaries and are consolidated with their parent corporation (§ 4.59 - § 4.61 of the 2008 SNA).

51. Subsidiaries that are wholly owned by a parent corporation and are created at the convenience of their parent (mainly for fiscal purposes) generally do not satisfy the definition of an institutional unit in the SNA because they lack the ability to act independently from their parent corporation and may be subject to restrictions on their ability to hold or transact assets held on their balance sheets. Their level of output and the price they receive for it are determined by the parent that is their sole client. They are treated as an integral part of the parent and their accounts are consolidated with those of the parent. This treatment is also applied to quasi-corporations such as a partnership or trust set up by a parent corporation for similar reasons to the artificial subsidiaries (§ 4.62 - § 4.65 of the 2008 SNA).

52. General government may also set up special units, with characteristics and functions similar to institutions just described. Such units do not have power to act independently and are restricted in the range of transactions they can engage in. They do not carry the risks and rewards associated with the assets and liabilities they hold. Such units, if they are resident, are treated as an integral part of general government and not as separate units. Thus, their accounts are consolidated with general government. In contrast, special units created by a non-resident government unit are treated as separate units (§ 4.67).

(Chart 2) Decision tree regarding the classification an SPE



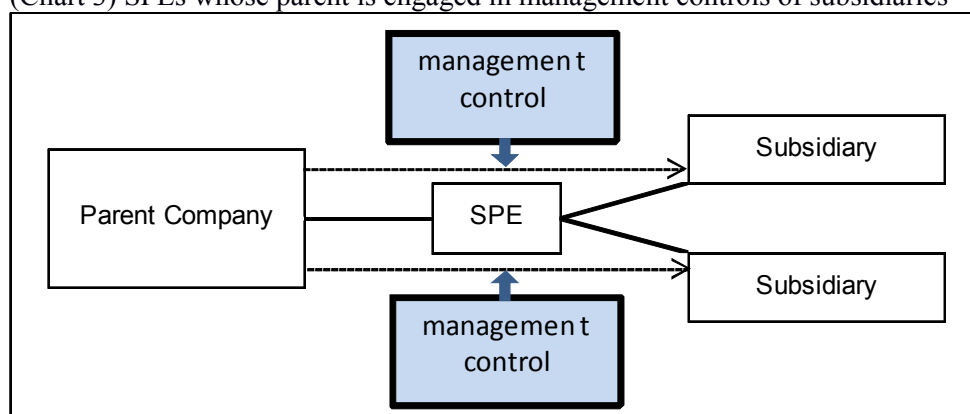
HOLDING CORPORATION VERSUS HEAD OFFICE (CHART 2-QUESTION 1)

53. In the sector classification of SPEs, compilers should, first of all, find out whether an SPE has subsidiaries. Then, the judgment is made on the provision of management services by the SPE. In general, an SPE is considered not to provide any management service and it should be classified as a holding corporation under Captive financial institutions and money lenders (S127). The rationale for this treatment is that SPEs cannot engage in management activities in the absence of human resources.

54. In some cases, an SPE may be created by the parent to hold shares of subsidiaries, and management controls are extended to the subsidiaries by its parent, rather than by the SPE. At first sight, one may want to classify such an SPE as a holding company. However, an alternative method could be to classify such an

SPE as a head office, by considering that management controls are delivered through the SPE. This interpretation is based on the fact that the subsidiaries of the SPE have no direct relationship with its parent⁵. If an SPE is regarded as a head office, a subdivision between Non-financial corporations (S11) and Financial auxiliaries (S126) is based on the activities of subsidiaries. If the majority of subsidiaries of the SPE are financial corporations, the SPE should be classified as Financial auxiliaries by convention irrespective of which financial subsectors the subsidiaries belong to (§ 4.53).

(Chart 3) SPEs whose parent is engaged in management controls of subsidiaries



55. In some countries, numerous SPEs are created by foreign parents to hold subsidiaries in foreign countries. Thus, the SPEs are not closely associated with countries' economic activities. In such a case, it is useful to create a separate subsector for such SPEs so that they could be separately identified and be excluded from national aggregates from an analytical point of view.

FINANCIAL CORPORATION versus NON-FINANCIAL UNIT (Chart 2-question 2)

56. Secondly, compilers should observe whether an SPE is engaged in the financial intermediation, if the SPE does not have subsidiaries. The financial intermediation refers to incurring liabilities on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market. All financial corporations except Financial auxiliaries (S126) are more or less engaged in such activities.

57. In contrast, a company holding non-financial assets, e.g., an SPE holding physical assets, real estates, natural resource mining rights or intellectual property rights and receiving rents and royalties for specific units, should be considered as a non-financial corporation given that it is not engaged in the financial intermediation by holding financial assets. In fact, one may assume that SPEs have financial assets in their balance sheets, but a large number of SPEs holding non-financial assets have been created in some countries to channel the investment income generated from such assets.

58. An SPE which is not engaged in financial intermediation can also be related to a general government unit. Based on the criteria regarding the independence as institutional unit, an SPE created by a resident government unit is usually regarded as part of general government (§ 4.67) and consolidated with it as long as the SPE transacts solely with a certain government unit(s) on either assets or liabilities. In contrast, an SPE created under private finance initiatives may have both government and private shareholders. Such an

⁵ Above alternative method is analytically useful. For example, in the case that the parent company of the SPEs is a non-financial corporation and their subsidiaries were created in the context of the relocation of manufacturing activities to foreign countries, classifying the SPE as non-financial corporation could generate more useful results than classifying it as a financial corporation.

SPE should be treated as an independent institutional unit, rather than being consolidated with general government.

59. An SPE created under private finance initiatives should be classified either in the General government sector or in the Non-financial corporations sector, based on their primary activities. Such an SPE would be classified under general government if the services it produces correspond to those formerly provided by the government and are regarded as non-market services (e.g. management of a prison). If not, the SPE is classified as a non-financial corporation and classified as a public non-financial corporation, national private non-financial corporation or foreign controlled non-financial corporation, depending on who controls the SPE.

SUBDIVISION WITHIN FINANCIAL CORPORATIONS SECTOR (Chart 2-question 3)

60. Thirdly, compilers should judge whether the financial intermediation are performed in the open market. Indeed, according to the 2008 SNA, Other financial intermediaries except insurance corporations and pension funds (S125) and Captive financial institutions and money lenders (S127) are distinguished by the fact that the transactions of their financial assets and their liabilities are carried out in open financial markets or not. (§ 4.109 and § 4.113). The former carries out transactions on both sides of the balance sheet in open markets, whereas the latter do not carry out transactions on either their assets or liabilities in an open market.

61. Dealing at market prices with counterparties including those outside of the enterprise group is one of the most important conditions of transacting in open markets. Thus, securitisation companies established for purchasing loans from a large number of banks and issuing asset backed securities or asset backed commercial papers to the public are classified in S125. In contrast, examples of SPEs to be classified in S127 are funding companies, i.e., SPEs liquidating financial assets and/or issuing securities for enterprises for financing a small number of enterprises⁶, captive settlement companies for enterprises in the same group and captive financial leasing companies for aircrafts and vessels.

62. Trusts are generally classified as Captive financial institutions and money lenders (S127), as trusts are often created for specific entities and thus their transactions are not made in open markets. However, if trusts are created to deal with counterparties in open markets, they should be classified under Other financial intermediaries except insurance corporations and pension funds (S125), or under Deposit-taking corporations except the central bank (S122) for those issuing substitutes of deposits such as money trusts.

63. An SPE used for investment funds is classified as Money Market Funds (S123) or Non-MMF investment funds (S124)⁷. However, investment funds created for specific entities should be classified under Captive financial institutions and money lenders (S127), as discussed above.

64. Captive insurance companies, including captive reinsurance companies, are distinguished from captive financial institutions and money lenders (S127) based on the difference in activities and are classified under Insurance corporations (S128, 2008 SNA, § 4.115).

⁶ The difference between captive financial institutions and head offices is to be noted. In some cases, head offices are engaged in the financing of enterprise groups as a part of their management activities. Such entities are serving their subsidiaries. Captive financial institutions are also engaged in financing but they are different from head offices in that financing is the main activity of capital financial institutions and they are serving their parent.

⁷ Trusts and investment funds may hold only non-financial assets in their balance sheets. The classification of such entities, e.g., as non-financial corporations (S11) or as financial corporations (S12), is also to be discussed.

TYOLOGY OF SPES

65. The table below represents the typology of SPEs with the descriptions of activities of various types of SPEs, except those to be consolidated with the parent, and their classification in the national and financial accounts. For an appropriate classification, their assets and activities should be carefully observed and judgments should be made based on the criteria proposed in the Charts 2.

Type of SPE	Major Activities	Classification
Holding Companies (terminology used in businesses)	Hold shares of subsidiaries and receive dividends	Captive financial institutions and money lenders (S127) - Non-financial corporations (S11) or Financial auxiliaries (S126) if management controls are provided
Companies Holding Non-financial Assets	Hold non-financial assets and receive rents/royalties	Non-financial corporations (S11)
Securitisation Companies	Hold liquidated financial assets and issue securities	Other financial intermediaries except insurance corporations and pension funds (S125) - Captive financial institutions and money lenders (S127) if they do not transact in open markets
Trusts	Hold assets	Captive financial institutions and money lenders (S127) - Other financial intermediaries except insurance corporations and pension funds (S125) if they transact in open markets - Deposit-taking corporations except the central bank (S122) if they issue substitutes for deposits
Investment Funds	Invest collected funds	Money market funds (S123) or Non-MMF investment funds (S124) - Captive financial institutions and money lenders (S127) if they do not transact in open markets
Funding Companies	Raise funds for same-group enterprises	Captive financial institutions and money lenders (S127)
Captive Settlement Companies	Deal with settlements for enterprises in the same group	Captive financial institutions and money lenders (S127)
Captive Leasing Companies	Deal with leasing for same-group enterprises	Captive financial institutions and money lenders (S127) - Non-financial corporations (S11) if they mainly deal with operational leases
Captive Insurance Companies	Deal with insurances for enterprises in the same group	Insurance corporations (S128)
PFI Units	Finance governmental projects in cooperation with private entities	General Government (S13) - Non-financial corporations (S11) if the projects are regarded as market activities

PROPOSALS FOR A WAY-FORWARD

66. For some countries, the consequence of the change in the sector allocation of holding companies from S11 to S12 (more precisely S127), and, at a lesser extent, the move of head offices, of which most subsidiaries are financial corporations, from S11 to S12 (by convention S126) could have a large impact in assets and liabilities of the non-financial corporations sector (S11) unless the strict definition of holdings is not followed. As a result, a very large shift might be observed on the measurement of some ratios (e.g., the debt-to-equity ratio) of both the non-financial corporations' sector (S11) and the financial corporations' sector (S12). In particular, the position of the new S127 (Captive financial institutions and money lenders) may, in some countries, exceed the financial positions of all other financial sub-sectors (except Deposit-taking corporations except the Central Bank S122).

67. Also, the allocation of SPEs to the new sectors and subsectors of the 2008 SNA classification may have a significant influence on the delineation of the two main sectors. As recognised by the AEG in its April 2012 meeting, more work needs to be done to identify the typology and sector classification of SPEs. The decision trees supplementing the 2008 SNA recommendation for identifying SPEs needs to be finalised and the impact of financial innovations and international transactions on SPEs needs to be further analysed.

68. For this reason, it is very important to be sure of the initial allocation of ISIC codes to all units, keeping in mind that it is the responsibility of the corporation to assign an ISIC code to itself when it registers. A supervision either by the national statistical office or by the national central bank, as it is already the case in some countries, should be extended to all OECD countries, on the basis of specific parameters to be determined, not only to ascertain the right allocation of units in the relevant ISIC class, but also for reasons of international comparability across countries. In addition, not only harmonised procedures should be defined for all countries to facilitate the selection of the ISIC code as it will be the first criteria to classify units according to 2008 SNA, but also a periodical review of this assignation in case of changes in activities of subsidiaries.

69. In order to follow up reflections on this topic, national practices as well as current research and work in countries, debates at the international level, and discussions between national experts of national statistical institutes and national central banks during the OECD WPFS-WPNA joint meeting, it is suggested to organise a Task Force on head offices, holding companies and possibly SPEs. The mandate of this Task Force could include the following elements:

- Define, if needed, additional qualitative criteria, and examine quantitative criteria for the distinction between holding companies and head offices,
- Further refine the typology and classification of SPEs (including a supporting decision tree), taking account of country practices as well as possible future changes in SPEs by financial innovations and international transactions,
- Make recommendations on the treatment of holding companies, head offices and SPEs in business registers and other sources of national accounts,
- Make recommendations on the treatment, more specifically on the recording and measurement of transactions and balance sheet items, of holding companies, head offices and SPEs.