Financial corporations within the *System of National Accounts 2008* framework

Money market funds (MMFs)and Non-MMF investment funds Other financial intermediaries, except insurance corporations and pension funds

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References

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Introduction

- The financial production and flows records transactions that involve financial assets and liabilities and that take place between Financial corporations and other sectors (residents and nonresidents).
- Financial corporations consist of all resident corporations that are principally engaged in providing financial services, including insurance and pension funding services, to other institutional units. Financial services are the result of financial intermediation, financial risk management, liquidity transformation or auxiliary financial activities. As the provision of financial services is typically subject to strict regulation, it is usually the case that units providing financial services do not produce other goods and services and financial services are not provided as secondary production.

Introduction

- ***Nonfinancial corporations***

  are corporations whose principal activity is the production of market goods or nonfinancial services. These include legally constituted corporations, branches of nonresident enterprises, quasi-corporations, notional resident units owning land, and resident nonprofit institutions that are market producers of goods or nonfinancial services.

- ***Financial corporations***

  Financial corporations consist of all corporations and quasi-corporations that are principally engaged in providing financial services, including insurance and pension fund services, to other institutional units. The production of financial services is the result of financial intermediation, financial risk management, liquidity transformation, or auxiliary financial services. In other manuals, financial corporations are sometimes called financial institutions.

Introduction

- The financial corporations sector is composed of the following set of resident institutional units:
  A. All resident financial corporations, regardless of the residence of their shareholders;
  B. The branches of non-resident enterprises that are engaged in financial activity on the economic territory on a long-term basis;
  C. All resident non-profit institutions that are market producers of financial services.

Introduction

- Financial corporations can be divided into three broad classes, namely:
  - financial intermediaries,
  - financial auxiliaries and
  - other financial corporations.

Introduction

- Financial intermediaries are institutional units that incur liabilities on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market. They consist of deposit taking corporations, investment funds, other financial intermediaries, insurance corporations, and pension funds.
- Financial intermediaries as institutional units collect funds from lenders and transform or repackage them (with respect to maturity, scale, risk, and the like) in ways that suit the requirements of borrowers. Through financial intermediation, funds are channeled between parties with a surplus on one side and those with a need for funds on the other. A financial intermediary does not simply act as an agent for these other institutional units but places itself at risk by acquiring financial assets and incurring liabilities on its own account.

Introduction

- Financial auxiliaries are institutional units principally engaged in serving financial markets, but do not take ownership of the financial assets and liabilities they handle or regulate.
- Other financial corporations are institutional units providing financial services, where most of their assets or liabilities are not available on open financial markets. These corporations are included in the captive financial institutions and money lenders subsector.

Introduction

- According to their activity in the market and the liquidity of their liabilities, the financial corporations sector can be divided into nine subsectors. Depending on the type of control, each subsector can also be further divided into the following subsectors:

    (a) Public financial corporations;

    (b) National private financial corporations;

    (c) Foreign-controlled financial corporations.

Financial corporations sector and its subsectors

- Central bank
- Deposit-taking corporations except the central bank
- Money market funds (MMFs)
- Non-MMF investment funds
- Other financial intermediaries except insurance corporations and pension funds
- Financial auxiliaries
- Captive financial institutions and moneylenders
- Insurance corporations
- Pension funds

What is a financial instrument ?

- Financial instruments comprise the full range of financial contracts made between institutional units.

- Financial instruments are classified as **financial assets** or as **other financial instruments.**

Financial Instrument

- **Financial assets** consist of **claims** and the **gold bullion component of monetary gold**.
  - A **claim** exists on another party, if there is a counterpart liability
    - The existence of the counterpart liability distinguishes financial claims from other economic assets, such as land, dwellings, machinery, equipment, etc.
    - When held by the monetary authorities, gold bullion is a financial asset, and a component of monetary gold.
    - It is considered a financial asset because of its role as a means of international payments and store of value for use in reserves,
    - Even though it is not created by an instrument and it does not represent a claim on another entity.

Financial Instrument

- Besides financial assets, there are **other financial instruments**: **contingent assets and liabilities.**
- Contingent assets are not recognized as economic assets because they do not give unconditional rise to requirements either to make payments or to provide other objects of value.
- However, by conferring certain rights or obligations that may affect future decisions, they can produce an economic impact on the parties involved.

Financial Instrument

Examples of contingent assets or liabilities:

- One-off guarantees of payment by third parties are contingent since payment is only required if the principal debtor defaults.

- Lines of credit, letters of credit, and loan commitments assure that funds will be made available, but no financial asset (i.e., loan) is created until funds are actually advanced.

Financial Assets and Liabilities

- ***Equity and investment fund shares***
  - Equity
  - Investment fund shares/units
- ***Debt instruments***
  - Special Drawing Rights
  - Currency and deposits
  - Debt securities
  - Loans
  - Insurance, pension, and standardized guarantee schemes
  - Trade credit and advances
  - Other accounts payable/receivable
- ***Other financial assets and liabilities***
  - Monetary gold
  - Financial derivatives and employee stock options

Debt Instruments

- Debt instruments are those instruments that require the payment of principal and/or interest at some point(s) in the future.

- Debt instruments comprise:
  - Special Drawing Rights
  - Currency and deposits
  - Debt securities
  - Loans
  - Insurance, pension, and standardized guarantee schemes
  - Trade credit and advances
  - Other accounts receivable/payable

Debt Securities

- *Debt securities* are negotiable instruments serving as evidence of a debt. They include bills, bonds, negotiable certificates of deposit, commercial paper, debentures, asset-backed securities, and similar instruments normally traded in the financial markets.

- *Debt securities* include some specific instruments, such as index-linked securities, bankers acceptances, and commercial paper.

Debt Securities

- Asset-backed securities, collateralized debt obligations, and collateralized mortgage obligations are arrangements under which payments of interest and principal are backed by payments on specified assets or income streams. They are backed by mortgages, home equity loans, student loans, and other debts, as well as pools of leased property.

- Index-linked securities are those where the principal and/or coupons are linked to another item, such as a price index or exchange rate.

Debt Securities

- *Stripped securities* are securities that have been transformed from a principal amount with coupon payments into a series of zero-coupon bonds, with a range of maturities matching the coupon payment date(s) and the redemption date of the principal amount(s).
- *Bankers' acceptances* involve the acceptance by a financial corporation, in return for a fee, of a draft or bill of exchange and the unconditional promise to pay a specific amount at a specified date. Much international trade is financed this way.

Money market funds (MMFs)

- *MMFs are collective investment schemes that raise funds by issuing shares or units to the public.* These funds issue shares (if a corporate structure is used) or units (if a trust structure is used).
- Investment fund shares or units refer to the shares issued by mutual funds and unit trusts, rather than the shares they may hold.
- *The proceeds are invested only or primarily in short-term money market securities, MMF shares and units, transferable debt instruments with a residual maturity of less than one year, bank deposits, and instruments that pursue a rate of return that approaches the interest rates of money market instruments. Such as treasury bills, certificates of deposit, and commercial paper.*

MMFs

- *MMF shares can be transferred by check or other means of direct third-party payment*. Because of the nature of the instruments that MMFs invest in, their shares or units may be regarded as close substitutes for deposits. MMF shares and units sometimes are functionally close to transferable deposits, for example, accounts with unrestricted check-writing privileges.
- In general, investment funds, including investment trusts, unit trusts and other collective investment schemes whose shares or units are seen as close substitutes for deposits, are classified as MMFs.

MMFs

- **MMFs do not include the following:**
    A. Head offices which oversee and manage a group consisting predominantly of MMFs, but which are not MMFs themselves. These are classified as financial auxiliaries;
    B. Non-profit institutions serving MMFs that are not engaged in financial intermediation. They are classified as financial auxiliaries

Non-MMF investment funds

- *Non-MMF investment funds are collective investment schemes that raise funds by issuing shares or units to the public*.
- The proceeds are invested predominantly in long-term financial assets and nonfinancial assets (usually real estate).
- Investment fund shares or units are generally not close substitutes for deposits. They are not transferable by means of check or third party payments.
- Some funds may be limited to certain investors only, whereas others are available to the public generally.
- Investment funds can be open or closed ended.

Non-MMF investment funds

- Open-ended funds or open funds are those whose shares or units are, at the request of the holders, repurchased or redeemed directly or indirectly out of the undertaking's assets.
- In Open-ended investment funds issue and redeem shares on a continuous basis: each time a new investment is performed, new shares or units are created; when shares are redeemed, an investment must be sold to match such redemption.
- Closed-ended, closed, or exchange-traded funds are those with a fixed share capital, where investors entering or leaving the fund must buy or sell existing shares.
- In Close-ended investment funds are open for subscription only during a specified period at the launch of the scheme; thereafter, investors can acquire shares only by buying them on a secondary market from other investors.

Non-MMF investment funds

- Investment funds may be constituted as follows:
    A. under the law of contract (as common funds managed by management companies),
    B. under trust law (as unit trusts),
    C. under a statute (as investment companies), or
    D. otherwise with similar effect.

Non-MMF investment funds

- Investment funds invest in a range of assets, such as debt securities, equity, commodity-linked investments, real estate, shares in other investment funds, and structured assets.

Non-MMF investment funds

- **In general, the following financial intermediaries are classified as non-MMF investment funds:**
  A. Equity based investment funds;
  B. Security based investment funds;
  C. Real estate investment trusts, which invest in debt and equity securities of companies that purchase real estate;
  D. Mortgage real estate investment trusts (REITs),which provide money to real estate owners and operators either directly in the form of mortgages or other types of real estate loans, or indirectly through the acquisition of mortgage backed securities;
  E. Investment funds investing in other funds (“funds of funds”);
  F. Hedge funds covering a heterogeneous range of collective investment schemes, typically involving high minimum investments, light regulation and a wide range of investment strategies;
  G. Private equity funds, which are collective investment schemes used for making investments in companies, many of which are not listed on a stock exchange;
  H. Exchange-traded funds (ETFs).

Non-MMF investment funds

- Fund managers of investment funds are financial auxiliaries.
- Mortgage REITs are different from equity REITs which directly own and manage real estate properties. The latter are not considered as financial intermediaries and, thus, are not part of the financial corporations sector.

Non-MMF investment funds

- **Non-MMF investment funds do not include:**

A. Pension funds which are part of the pension funds subsector;

B. Special purpose government funds, usually called sovereign wealth funds, which are classified as captive financial institutions, given the nature of their liabilities, if classified as a financial corporation;

C. Head offices that oversee and manage a group consisting predominantly of non-MMF investment funds, but which are not investment funds themselves. These are classified as financial auxiliaries;

D. Non-profit institutions serving non-MMF investment funds, but not engaged in financial intermediation. They are classified as financial auxiliaries.

Method to compute output

- **Money market funds (MMFs)**

Output comprises a combination of the following fees:

- Purchase and redemption fees, which are calculated as a percentage of the purchase and redemption values of the units/shares;
- Exchange fees;
- Account fees;
- Annual recurring fees, such as management fees, distribution and/or service fees and other fees based on a percentage of a fund’s asset value.

Method to compute output

Non-MMF investment funds

Output comprises a combination of the following fees:

- Purchase and redemption fees which are calculated as a percentage of the purchase value and redemption value of the units/shares;
- Exchange fees;
- Account fees;
- Annual recurring fees, such as management fees, distribution and/or service fees and other fees based on a percentage of a fund's asset value;
- Performance fees (likely to be more applicable to hedge funds), which are calculated as a percentage of the profits earned by the funds

Other financial intermediaries, except insurance corporations and pension funds

- *Other financial intermediaries, except ICPFs, consist of financial corporations and quasi-corporations that are engaged in providing financial services by incurring liabilities, in forms other than currency, deposits, or close substitutes for deposits, on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market, and that are not included in another subsector*.

- It is a feature of a financial intermediary that operations for both sides of the balance sheet are carried out in open markets.

Other financial intermediaries, except insurance corporations and pension funds

- This subsector includes financial intermediaries predominantly engaged in long-term financing. This predominant maturity distinguishes this subsector from deposit-taking corporations except the central bank and money market funds subsectors. Based on the non-existence of liabilities in the form of investment fund shares or units which are not seen as close substitutes for deposits or insurance, pension and standardized guarantee schemes, the borderline with the non-MMF investment funds, insurance corporations and pension funds subsectors can be determined.

Other financial intermediaries, except insurance corporations and pension funds

- **In general, the following financial intermediaries are classified in this subsector:**

  - financial corporations engaged in the securitization of assets (financial vehicle corporations);

Securitization involves raising funds by selling a security backed by specific assets or income streams. For example, an originating mortgage lender could sell a portfolio of loans to a special purpose vehicle that issues units sold to investors. The originator may continue to provide administrative services, but the vehicle is the legal owner of the portfolio. Such vehicles are included in "other financial intermediaries, except ICPFs" if the entity is the legal owner of a portfolio of assets, sells a new financial asset that represents an interest in the portfolio, and has or potentially has a full set of accounts.

Other financial intermediaries, except insurance corporations and pension funds

- **In general, the following financial intermediaries are classified in this subsector:**

  - underwriters, and securities and derivative dealers (operating on own account). In contrast, security brokers and other units that arrange trades between buyers and sellers but do not purchase and hold securities on their own account are classified as financial auxiliaries;

  Derivatives are financial instruments that are linked to a specific financial instrument, indicator or commodity, through which specific financial risks can be traded in financial markets in their own right.

Other financial intermediaries, except insurance corporations and pension funds

- financial corporations engaged in lending, including financial leasing, as well as personal or commercial finance; Specific examples of these financial corporations include property companies, as well as aircraft and other transport leasing companies which specialize in financial leasing, and the finance associates of retailers.

A financial lease is one where the lessor as legal owner of an asset passes the economic ownership to the lessee who then accepts the operating risks and receives the economic benefits from using the asset in a productive activity.

Other financial intermediaries, except insurance corporations and pension funds

- central clearing counterparties, which provide clearing and settlement of market transactions in securities and derivatives.

Clearing relates to identifying the obligations of both parties to the transaction, while settlement is the exchange of the securities or derivatives and the corresponding payment. The central clearing counterparties involve themselves in the transaction and mitigate counterparty risk;

Other financial intermediaries, except insurance corporations and pension funds

- specialized financial corporations that assist other corporations in raising funds in equity and debt markets and provide strategic advisory services for mergers, acquisitions, and other types of financial transactions. (These corporations are sometimes called "investment banks.") In addition to assisting with the raising of funds for their corporate clients, such corporations invest their own funds, including in private equity, in hedge funds dedicated to venture capital, and in collateralized lending.

- if such corporations take deposits or close substitutes for deposits, they are classified as deposit-taking corporations.

Other financial intermediaries, except insurance corporations and pension funds

- Specialized financial corporations that provide the following:
  - Short-term financing for corporate mergers and takeovers.
  - Export/import finance.
  - Factoring services.
  - Venture capital and development capital firms.
  - Loans against mortgage on real estate by issuing mortgage bonds. (mortgage credit institutions)

Other financial intermediaries, except insurance corporations and pension funds

This subsector does not include:

- Head offices which oversee and manage a group of subsidiaries principally engaged in financial intermediation and/or in auxiliary financial activities — these are classified as financial auxiliaries;
- Non-profit institutions serving other financial intermediaries, but not engaged in financial intermediation — these are classified as financial auxiliaries.

Method to compute output

Other financial intermediaries, except insurance corporations and pension funds:

- Financial corporations engaged in the securitization of assets
  - ❖ Output is the value of the explicit fees
- Security and derivative dealers (operating on own account)
  - ❖ Output is the difference between the buying price (or ask price) and mid-price, and the mid-price and selling price (or bid price) of the financial instrument that is exchanged.

Method to compute output

- Financial corporations engaged in lending, including financial leasing, hire purchase and the provision of personal or commercial finance
  - ❖ Output comprises a combination of the following:
    - ❖ Explicit fees;
- Implicit financial services provided, which are calculated as $(r_L - r_r) \times Y_L$, where r_L , r_r and Y_L represent the lending rate, reference rate and average stock of loans respectively.

- Central clearing counterparties
  - ❖ Output is the value of the explicit fees.

Method to compute output

- **Specialized financial corporations that assist other corporations in raising funds in equity and debt markets and provide strategic advisory services for mergers, acquisitions and other types of financial transactions**
  - Output is the value of the explicit fees

- **Specialized financial corporations that provide short term financing for corporate mergers and takeovers; export/ import finance; factoring services; venture capital and development capital firms; loans against mortgage on real property by issuing mortgage bonds**
  - Output comprises a combination of the following:
    - Explicit fees;
    - Implicit financial services provided, which are calculated as $(rL-rr)\times YL$, where rL , rr and YL represent the lending rate, reference rate and average stock of loans respectively

Thank you so much for your kind attention