

PRODUCT AND ACTIVITY CLASSIFICATIONS FOR
FINANCE AND INSURANCE

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INTRODUCTION

There is a difficulty in separating product and activity classifications. For example, finance and insurance products are products which are principally produced by the finance and insurance industry. At the same time finance and insurance industries are the producing units whose products are mainly finance and insurance products. The process of delineating activity and product classifications is both intuitive and iterative. After several iterations, the product classification will include all products which are principally produced by the finance and insurance industry.

The principal function of financial services is characterized as the provision of time and space utility of money. The principal function of insurance is the management of risk, that is, the spreading or pooling of risk. Another way of describing these two processes is to say they transform the space time, risk and yield attributes of financial assets.

Not only finance and insurance industries are involved in the transformation of space time, yield and risk. This is something in which every business is involved. The process that is fundamental to finance and insurance industries is that they are intermediaries in the transformation process. In the case of finance they intermediate between those who need funds and those who have funds for investment by entering into a contract with both. in the case of insurance they enter into agreements with many clients who wish to reduce their risk of contingent financial loss.

This is usually viewed as the essential function of finance and insurance. In examining the industries that are usually viewed as finance and insurance, there are a number of products that are characteristic of those industries but do not fit within this general description. For example, stock broking in which securities are exchanged with the assistance of stock brokers, the stock brokers do not assume the risk. Also few of the products provide only one service to the client. A holder of a bank account may prefer a bank account to other investments because the bank account provides a means of payment (space utility), a reduced risk, accounting statements, and other services.

THE PRODUCT CLASSIFICATION

This classification has two related but different objectives:

- to provide a general framework that will organize finance and insurance products into logical groupings (from a production point of view) and
- to provide a comprehensive list of finance and insurance products.

For the list to be comprehensive all of the other services associated with finance, monetary and insurance instruments and claims must be examined. Instruments are used in the sense of the documentation of a contract but also in the sense of the terms and conditions of the contract. Most but not all services related to these instruments and claims could be considered finance or insurance products. There are exceptions, for example, legal services associated with these instruments.

In addition, there are a number of activities such as brokerage, and management of the exchange of existing claims or instruments which are considered to be financial regardless of the nature of the instrument involved. Two examples of this are trading in commodity futures and factoring - which involves the purchases of trade receivables at a discount. Therefore another approach that is useful in devising a classification is to consider some general functions that relate to instruments or to financial and insurance industries.

They are:

1. Financing and Insurance Purchasing Decisions

This involves the decision to seek financing (or self-finance), the amount, timing and type of financing instrument to use. It also involves the decision to obtain insurance (or self insure), and the amount, timing and type of insurance to obtain. In this case the entity involved in the financing - or an associated entity - is one party to the claim that is created.

These decisions are usually part of the management decision of a business or the investment decisions of a natural person. Businesses typically make them on their own behalf although advice may be sought from finance or insurance industries. Some financial institutions do make this kind of decision on their own behalf but usually this is not a final product. There is another circumstance in which it is

necessary to include such a product in the classification. If the model of production defines an establishment as having, inter alia the responsibility for financing decisions, then this is a necessary product to measure production of that unit.

2. Intermediation

Once the financing or insurance decisions have been made intermediation may be involved. This has been described earlier as one function that is associated uniquely with finance and insurance.

3. Portfolio Management of Instruments

This consists of the process involved in deciding which instruments to hold. The previous category may include an element of portfolio management.

4. Exchange of Instruments

This consists in the exchanging of instruments including buying, selling and redemption of financial, insurance and other instruments. There are a variety of functions included in this process, for example, managing the markets where the exchange takes place, acting as an agent of the seller or purchaser, or acting as a broker. Some sub headings of this category are:

- (a) retail sales of new instruments e.g sale of mutual fund shares
- (b) wholesale sales of new instruments e.g. stock sales to other brokers
- (c) management of the markets for exchange of instruments e.g. stock exchanges
- (d) brokerage of existing instruments e.g. mortgage brokerage

5. Advising or Counselling or Market Intelligence

Advice or counsel can be provided relating to any of the functions described. One of the most common forms of advice and counsel to businesses is provided in making their financing decisions and in issuing of new stocks or bonds. Another common form is advice to portfolio managers.

6. Issuing of New Instruments

The administrative operations necessary to create the instrument. This service is also often self provided although it may be provided by financial industries as in the issuing of stocks.

7. Physical Management of Instruments

The physical management consists of the processes involved in maintaining and servicing instruments, for example, record keeping. Some such services are the administrative operations associated with bank accounts.

8. Auxiliary Services Relating to Instruments

Auxiliary services are a catchall. These are services usually associated with finance and insurance but which are not part of the functions already mentioned. Included are the regulation of finance and insurance. Another related service which is important is the implementation of monetary policy.

These general headings and an examination of the instruments themselves help ensure that the list of finance or insurance services is complete. However, it cannot be used as the sole basis of the structure of the classification.

Products may consist of part of one or combinations of these basic functions. The combinations may change over time. The products may be bundled into other products. An example of a relatively simple service is the retail sale of insurance policies by independent agents. Underwriting of a stock issue can be a relatively complex product combining part of the issuing of stock, the wholesaling of the stock and the retailing of the stock. A checking interest bearing account involves a complex combination of services - including the issuing of a new account, physical management of the account and the exchange of instruments. A bank account is further complicated in that the charge for the service is implicit, that is, it is the combination of interest foregone and the explicit service charges. A part of the bank account services may be bundled into another service package for which there is a monthly charge. This bundle could include discounts on loan rates, traveller's cheques, and safety deposit boxes as well as free checking privileges. This is a complication both in defining commodities and estimating prices/movements although it is not a unique problem for finance and insurance. The point is that these general headings alone cannot provide a basis for the classification framework any more than the instruments. Consequently some combination of the two will probably be required.

When the name of an instrument is used in a classification it is important to distinguish the bundle of services from the claim referred to by the same name. The use of the name is appropriate since quite often the name refers to a service bundle which has the necessary characteristics for price and quantity measurement. By this is meant that grouping of products with the same name will result in a relatively homogeneous group of products which are different from other products with different names. Products grouped within the same grouping, since they are intended to be the basis for real output measurement, are expected to have similar price movements.

The bundle of services associated with the product can differ over time and across establishments within the same time period. This clearly leads to problems in pricing and measuring real output. However, this problem is not unique to financial services nor even to services.

In the financial industries, the management, clients and regulators are more interested in such information as return, security, solvency, and portfolio decisions than in service costs and prices. Furthermore the study of financial industries is relatively more concerned with the measurement of financial markets - the value of financial flows they handle - than with the measurement of output. Those interested in financial markets are more interested in the effectiveness of finance and insurance intermediaries in raising and redistributing funds. The pursuit of these interests requires detailed information on the balance sheet or source and application of funds. Consequently the statistician concerned with production data must deal with respondents whose willingness to provide data has already been exhausted by regulatory requirements. In addition, data to meet these regulatory requirements is usually only of marginal value in the measurement of production.

There is one further complication in the case of the financial industries which is almost a corollary of the previous paragraph. The laws that permit the existence of financial and insurance businesses often define the boundaries between units. This primarily affects the industry classification but it can also affect the products that are provided. These distinctions then tend to get embedded in terminology of the financial industries. One point is that it may be difficult to construct a terminology that is familiar and acceptable to all countries.

There is one other implication of this circumstance. Legal changes in these boundaries, for example deregulation, affect the types of products and product bundles that are produced. The problem of maintaining continuity and the need for a revolutionary change in the product classification is more likely than in non-regulated industries. As much as possible the services should be

described in general terms and also it is prudent not to link the products to particular industries or institutions.

In the broad structure of the proposed classification, the first heading is one that relates to monetary services, that is, those associated with monetary policy.

1. Monetary Services

These are services related to the implementation of credit policy, exchange rate management and currency issuing.

The principal function of financial services is intermediation. The following three headings describe services which are all related to this basic function, that is, they all have an element of intermediation. However, each category has some distinctive characteristic likely to affect its price movement and level. Deposit services do not entail much risk for the deposit taker. However, there is a substantial physical management involved in deposit taking. On the other hand, credit services involve a risk on the part of the lender. Underwriting of stocks and bonds involves a substantial risk on the part of the underwriter who purchases the security from the issuer and risks a loss on the resale of the security. There may also be a substantial wholesaling and retailing function involved. The last category provides a classification for any other intermediation functions that have not been specified.

2. Deposit Services

This service usually includes a number of functions including the issuing and closing accounts, exchanging cheques or withdrawal slips for money, transferring money between accounts, and providing documents to the client. The price of deposit services is usually not explicit.

3. Credit Services

The issuing of loans and the physical management of the loans. The part of the loan payment which is the payment for the credit service is not explicit. Even though the prices are not explicit, it is apparent that a variety of loan types exist with different service prices.

4. Underwriting of Stocks and Bonds

Underwriting is a service in which the underwriter agrees to purchase stocks or bonds at a fixed price

and sell at what the market determines as an appropriate price. This is sometimes referred to as a "bought deal". The service usually includes wholesaling of the security and often retailing as well. Excluded are "best efforts" arrangements in which the broker agrees to extend best efforts to sell the security.

5. Other Intermediation

This includes such activities as the purchase of loan claims and purchase of invoices (factoring). Also included would be underwriting of travellers cheques.

The next category - portfolio management - involves some element of risk but the risk is limited since the portfolio management is on behalf of a group of investors, that is, the investor accepts the risk in this case.

6. Portfolio Management

This service consists of making decisions on which investments to purchase and sell. Advisory services are listed elsewhere. This service can be provided to persons or businesses.

The next three categories are different services involved in the exchange of instruments. None of these categories involve financial industries as intermediaries.

7. Brokerage Services

Brokerage is the service of bringing together purchasers and sellers of the same instrument.

8. Financial Retailing Services

Selling to the final consumer, instruments that are produced by another establishment.

9. Security and Exchange Management Services

This service consists of the management of exchanges where securities or other contracts are traded.

The next category is the provision of advice or information that will assist in portfolio management or will assist businesses in making their financing decision.

10. Advice and Market Intelligence

This service consists of the provision of advice on investments for purposes of portfolio management. It includes any instrument in which trading occurs and need not be limited to stock exchanges or other formal markets. Included is the provision of advice to businesses in making their financing decisions.

The final service is a catchall for a variety of products that are usually produced by the finance industries.

11. Auxiliary Services to Financial and Monetary services

Underwriting is the more common name for intermediation for insurance services. Risk is spread by entering into arrangements with a group of clients.

12. Insurance Underwriting Services

The writing of insurance policies in which the insurer agrees to compensate the client for certain kinds of financial losses.

Pension fund management services involves some decision making but the pension fund manager is managing on behalf of the contributors and ultimate beneficiaries. The pension fund manager does not bear the risk associated with the decisions and is not involved in intermediation. A substantial amount of physical management is involved.

13. Pension Fund Management Services

The management of pension funds including the administration of payments and receipts, portfolio management of the reserves and usually the assessment of the fund from an actuarial point of view.

Insurance agency and brokerage services are primarily a retailing service although there are some advisory services involved. There is no risk involved for an agent and broker.

14. Insurance Agency and Brokerage Services

The sale to the final consumer of insurance policies underwritten by others.

Auxiliary services are a catchall category for services which are normally considered part of insurance industry services but which are not covered by the first two categories.

15. Auxiliary Services to Insurance and Pension Fund Management

The final category is the regulation of finance or insurance industries, claims or transmits.

16. Regulatory Services

The monitoring and enforcement of rules and regulations usually intended to protect the consumer.

Financial Products

1. Monetary Services

1.1 Reserve and Interest Rate Management

This service involves the management of reserves in the central bank and the management of interest rates.

1.2 Exchange Rate Management

This service involves the management of exchange rates, through the sale of foreign and national currencies.

1.3 Currency Issuing and Management

This service involves the distribution of banknotes and currency.

2 Deposit Services

2.1 Chequing Deposit Accounts

Chequing deposit accounts are deposit accounts which can be redeemed by cheque.

These chequing deposit accounts may be called such names as personal chequing accounts, and bankbook deposit accounts.

2.2 Non-Chequing Deposit Accounts

Non-chequing deposit accounts are deposit accounts which cannot be redeemed by cheques. The holder must redeem them in person, at a teller of a deposit institution.

These non-chequing demand deposits might be called savings accounts or T-Bill accounts.

2.3 Term Deposits

Term deposits are deposits which can on principle be redeemed only at term. In fact, deposit institutions redeem them before term, upon payment of a penalty.

Term deposits are sometimes called certificates of deposits, or guaranteed investment certificates.

2.4 Segregated Funds Management

Segregated fund deposits are deposits which is accounted for separately, and sometimes earmarked for a special purpose.

2.5 Other Deposit Services

This is a residual category allowing for some types of deposits not specifically mentioned or new forms which may appear in the future.

3 Credit Services

3.1 Line of Credit Loans

A line of credit is an agreement to pay orders on deposit accounts which do not contain the funds. Lines of credit become loans when the holder of a demand deposit withdraws the money from his account.

3.2 Consumer Loans

Consumer loans are loans extended to allow the borrower to buy consumer goods. The purchased good is generally used as a collateral.

3.3 Personal Instalment Loans

Personal instalment loans are loans extended to private persons, which must be reimbursed according to a schedule of payments. The loans may or may not be secured by collateral. However, they are not secured by the good being purchased.

3.4 Credit Cards

Credit card loans are loans which are made when the holder of a credit card uses it to buy a good or a service.

3.5 Mortgage Loans

Mortgage loans are loans which are made on the collateral of a real estate asset, usually to allow purchase of the asset.

3.6 Commercial Loans

Commercial loans are loans to businesses.

3.7 Rediscounting of Loans and Commercial Paper

This product consists in the rediscount and the trade of commercial paper.

3.8 Financial Leasing

Financial leasing is a loan which is extended to businesses and, sometimes, to private parties, in order to allow them to lease a good.

3.9 Acceptances

An acceptance is an agreement, by a bank or a financial institution, to pay a draft or a credit instrument issued by a business.

3.10 Demand Loans

Demand loans are loans which are redeemable on demand.

3.11 Other Credit Services

4 Underwriting of Stock and Bond Issues

Underwriting of stock and bonds is the buying, by specialized firms or commercial banks, of entire issues of bills, bonds or stocks, in order to re-sell them. The underwriter agrees to buy the security. This is sometimes referred to as a "bought deal". A "best efforts" deal is considered to be either wholesaling or retailing or both.

5 Other Intermediation

5.1 Factoring

Factoring is the purchase of loan claims and invoices.

5.2 Portfolio Management on Own Account

5.3 Underwriting of Travellers Cheques

5.4 Other Intermediation N.E.S.

6 Portfolio Management

6.1 Open End Fund Management (Mutual Funds)

Open end funds are portfolios managed by specialized financial institutions or by specialized branches of banks or trust companies. These portfolios are constituted by pooled resources from the public. Whenever a client buys a share, or a unit the amount which is pooled increases.

6.2 Closed End Fund Management

Closed end funds are portfolios which are managed by specialized financial institutions or by specialized branches of banks or trust companies. Ownership of these portfolios is divided into shares, and the value of the share varies according to the value of the portfolio. The number of shares is fixed.

6.3 Personal Portfolio Management

Management of the investment portfolios of individuals.

6.4 Other Portfolio Management

7 Brokerage Service

7.1 Wholesaling of Stocks and Bonds

This service consists in the sale of large quantities of newly issued securities on behalf of underwriters or issuers.

7.2 Loan Brokerage

Brokerage services related to loans.

7.3 Mortgage Brokerage

Brokerage services related to mortgages.

7.4 Stock Brokerage

Brokerage services related to existing stocks and bonds.

8 Financial Retailing Services

8.1 Retailing of new stock and bond issues

8.2 Retailing of Mutual Funds Shares

8.3 Retailing of Other Fund Shares

8.4 Travellers Cheque Services

This product consists of the sale of travellers cheques.

8.5 Other Retailing Services

9. Security and Exchange Management Services

9.1 Security Exchanges

Security exchanges are places where securities are exchanged on behalf of their owners.

9.2 Gold or Silver Bullions Exchanges

Gold or silver bullion exchanges are places where silver or gold bullions certificates are exchanged.

9.3 Commodity Exchanges

Commodity exchanges are places where claims on merchandises are exchanged on behalf of their owners.

9.4 Other Exchanges

10 Advice and Market Intelligence

10.1 Personal Financial Planning

Personal financing planning is the sale of advice on personal financial decisions. It frequently includes the retailing of securities and may include RRSP sales, and estate and tax planning.

10.2 Security Market Analysis and Intelligence

This product consists of the provision of advice concerning the stock and the commodity markets. It may also include the provision of stock quotations or other information whether through documents or electronic means and includes advisory pamphlets and letters.

10.3 Other Advice and Market Intelligence

This would include advice on investment in instruments other than securities.

11 Auxiliary Services to Financial and Monetary Services

11.1 Money Transfer

This service consists in transferring money from one location to another.

11.2 Safety Deposit Services

This product consists of the rental safe deposit boxes to the public, or in safekeeping goods which belong to other persons.

11.3 Foreign Currency Exchange Services

This product consists in exchanging currencies.

11.4 Cheque Clearing

The clearing of cheques between institutions and branches.

11.5 Security Registration and Payment Services

The registration of securities and payment of all interests and dividends.

11.6 Other Financial Services

12 Insurance Underwriting Services

12.1 Life Insurance

Payment is made upon the death of the policy holder.

12.2 Health Insurance

Payment is made if the policy holder incurs expenses because of sickness.

12.3 Income Maintenance Insurance (Including Disability)

Payment is made if the policy holder can not continue to earn an income due to specific conditions such as disability.

12.4 Personal Liability Insurance

A claim is incurred if the policy holder becomes personally liable to make payments under certain specified conditions.

12.5 Personal Property Insurance

A claim is incurred if personal property of the policy holder is damaged, destroyed or lost in certain circumstances.

12.6 Homeowners Packages

An insurance policy usually combining insurance of personal property, home insurance and personal liability insurance.

12.7 Unemployment Insurance

A claim is paid if the policy holder loses his employment.

12.8 Motor Vehicle Insurance

This insurance consists of liability insurance of the policy holder in operating a motor vehicle and insurance against some types of damage or loss to vehicles owned by the policy holder.

12.9 Commercial Fire and Theft

A policy covering damage to commercial property caused by fire or theft.

12.10 Commercial Liability Insurance

Insurance protecting the policy holder from losses resulting from certain liabilities of a business.

12.11 Other Insurance

13 Pension Fund Management Services

This service consists in the management of pension funds.

14 Insurance Agency and Brokerage Services

This product consists in the sale of insurance contracts provided by the underwriters to the public. This product is usually sold by insurance agents or brokers. However, a variety of insurance is sold by other businesses.

14.1 Personal Life Insurance

14.2 Commercial Life Insurance

14.3 Health Insurance

14.4 Income Maintenance Insurance

14.5 Personal Liability Insurance

14.6 Personal Property Insurance

14.7 Homeowner Packages

14.8 Motor Vehicle Insurance

14.9 Commercial Fire and Theft Insurance

14.10 Other Insurance

15 Auxiliary Services to Insurance and Pension Fund Management

Auxiliary services to insurance and pension funds.

15.1 Risk Pooling and Reinsurance

The pooling of resources in order to insure a risk which, if the condition is met, would generate a payment too high for a single fund, or the finding of another insurer which is ready to take part of the risk.

15.2 Insurance Adjustment Services

The evaluation and settlement of the loss incurred by the policy holder.

16 Regulatory Services

16.1 Regulation of Deposit and Loan Services and Institutions

This service comprises the regulation of deposit and loan services and institutions providing these services.

16.2 Regulation of the Securities Market

The regulation and monitoring of the securities market and participants in those markets.

16.3 Regulation of Insurance

This service consists in the regulation and monitoring of insurance indemnities.

THE ACTIVITY OR INDUSTRY CLASSIFICATION

Much of the general background necessary to design the activity classification has already been covered in the review of the product classification. One point is that institutional arrangements vary by country. Clearly these institutional requirements cannot all be reflected in an industry classification intended to apply to all countries. In any case, institutional distinctions are not necessarily important from a production point of view.

If there is to be a single industry classification and that classification is used for more than one purpose, for example, to analyze the effect of institutional arrangements on the intermediation function, then additional industry classes may be needed. Neither of these two factors has been considered in the proposed classification.

The industry classification attempts to make similar distinctions to those made in the product classification.

Industry Classification for Finance and Insurance

1 The Central Bank

The central bank regulates the money supply, issues currency, regulates interest rates and the credit market, and advises the government on financial matters.

2 Deposit Taking and Credit Granting Intermediaries

These institutions provide deposit and credit products. There are often different institutions that fit within this category in each country, but these distinctions are not important from the production point of view.

2.1 Commercial Banks

Banks provide a wide range of deposit and credit services. In Canada, they can be called Banks, caisses populaires and credit unions, or trust companies. They all provide basically the same financial product.

2.2 Other Deposit Taking and Credit Granting Intermediaries

This includes intermediaries which are specialized in terms of either the credit or the deposit service provided.

2.2.1 Deposit Accepting Mortgageors

These institutions accept deposits and sell mortgages.

2.2.2 Cooperative Mortgageors

These institutions accept deposits from their members and sell mortgages to their members.

3 Consumer and Business Financing

3.1 Sales Finance

Businesses providing loans to finance the sale of consumers goods.

3.2 Financial Leasing

Businesses financing the long term rental of consumer or investment goods.

3.3 Business Financing

Businesses primarily providing capital for new investment businesses.

3.4 Other Business Financing

4 Security Agents and Brokers

Businesses specializing in the underwriting, wholesaling, retailing and brokerage of securities.

5 Other Intermediaries

5.1 Factors and Rediscounters

Businesses specializing in factoring and intermediation or brokerage services between intermediaries.

5.2 Holding Companies

They manage portfolios on behalf of their shareholders.

6 Portfolio Managers

Those institutions are principally the mutual funds, and businesses who manage personal portfolios on behalf of their clients, and who make decisions about the content of these portfolios.

6.1 Personal Portfolio Managers

Businesses which manage the portfolios of individuals, trusts or estates.

6.2 Closed End Mutual Funds

Managers of closed end portfolios on behalf of their stockholders.

6.3 Open End Mutual Funds

Managers of open-end portfolios on behalf of their stockholders.

6.4 Mortgage Fund Managers

Managers of mortgage funds.

7 Security and Commodity Exchanges

Managers of stock or commodity exchanges, where securities are traded. They provide a place where the securities are offered and purchased by brokers and agents on behalf of the buyers and sellers.

8 Investment Advisors and Researchers

9 Other Financial

10 Insurance Underwriters

Businesses involved in the underwriting of insurance policies. They redistribute the risk.

10.1 Life Insurers

10.2 Health Insurers

10.3 Income Maintenance Insurers

10.4 Property and Casualty Insurers

10.5 Re-Insurers

These underwriters insure other underwriters.

10.6 Other Insurers

11 Insurance Agents and Brokers

They retail insurance contracts provided by the underwriters.

12 Auxiliary Service to Insurance and Pension Fund Management

12.1 Insurance Advisors

12.2 Insurance Adjusters

Insurance adjusters determine the value of the payment to be made by the insurance underwriter.

12.3 Actuaries

13 Other Insurance

14 Finance and Insurance Regulators

14.1 Financial Regulators

Commodity and Security Exchange Regulators.

14.2 Other Financial Market Regulators

14.3 Insurance Regulators