IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS AND OECD WORKSHOP ON INTERNATIONAL INVESTMENT STATISTICS

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

ISSUE PAPER #30

MUTUAL FUNDS

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Prepared by the Bank of Japan

November 2004

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1. Current international standards for the treatment of the direct investment item
Mutual funds are not clearly defined in the IMF *Balance of Payments Manual, fifth* edition *(BPM5)* or the OECD *Benchmark Definition of Direct Investment, third edition (BD3)*. Related descriptions are as follows;

(a) "Direct investment is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise" (*BPM5*, paragraph 359).

"The benefits that direct investors expect to derive from a voice in management are different from those anticipated by portfolio investors having no significant influence over the operations of enterprise. Portfolio investors will evaluate, on a separate basis, the prospects of each independent unit in which they might invest and may often shift their capital with changes in these prospects, which may be affected by short-term developments in financial markets" (*BPM5*, paragraph 361)

"A direct investment enterprise is defined in this Manual as an incorporated or unincorporated enterprise in which a direct investor, who is resident in another economy, owns 10 percent or more of the ordinary shares or voting power or the equivalent" (*BPM5*, paragraph 362).

"Mutual funds and investment trusts also are included" (*BPM5*, paragraph 388<Portfolio Investment>).

(b) *BD3*, paragraphs 5, 7 and 109

2. Concerns of the current treatment
According to the above descriptions shown in the *BPM5* and the *BD3*, mutual funds could be classified in two ways. Thus the way of classifying these funds might differ across countries, and result in bilateral asymmetries and international discrepancies where counterpart countries apply another way of classification. Two criteria for classifying mutual funds are as follows;

(a) 10 percent criterion; investment in/from mutual funds is recorded as equity capital of Direct Investment, if the percentage of ownership is 10 percent or more.

(b) Actual control criterion; investment in/from mutual funds is recorded as equity capital of Direct Investment, regardless of the percentage of ownership.

3. Possible alternative treatments

According to the distinguishing features of Direct Investment, i.e. significant influence of direct investors on management, it is desirable to classify investment in/from mutual funds as equity investment of Portfolio Investment, not as equity capital of Direct Investment, regardless of the percentage of ownership.

However, the way of classifying specific types of mutual funds needs to be examined further. They are hedge funds[1], distressed funds[2], and feeder/master arrangements[3].

4. Points for discussion

1. Do DITEG members consider that it is appropriate to classify mutual funds and hedge funds into Portfolio Investment, regardless of the percentage of ownership?

2. Do DITEG members consider that it is appropriate to classify distressed funds and feeder/master funds into Direct Investment as an exception of above treatment, if the percentage of ownership is 10 percent or more?

5. Supplementary information

NA

6. Annex of the most relevant documents

IMF [2001], *Mutual Funds and "Fund of Funds": Portfolio Investment or Direct Investment?*, BOPCOM-01/22
R. Kozlow [2002], *Exploring the Borderline Between Direct Investment and Other Types of Investment: The U.S. Treatment*, BOPCOM-02/35
Bank of Japan [2002], *The Treatment of Corporate-type Mutual Funds*, BOPCOM-02/36
R. Kozlow [2003], *Investment Companies: What are they, and Where Should they be Classified in the International Economic Account?*, BOPCOM-03/22

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[1] Investors generally invest in hedge funds to obtain investment returns in a short-term asset management, not a lasting interest based on the control or management, and thus these funds could be regarded as de-fact Portfolio Investment.

[2] As for distressed funds, investors are willing to participate in the control or management of the enterprise for a specified period, in order to redevelop or enhance the enterprise value. Their controlling or managing attitudes in a long-term relationship are features of Direct Investment.

[3] In many cases, feeder/master funds are set up in different jurisdictions as different legal structures to acquire preferential treatments related to taxation or securities regulations in the process of asset-management, thus result in a certain amount of cross-border transactions. Since a common fund manager is delegated to set up these arrangements and make investment decisions on behalf of investors (the purpose of investors is to gain a short-term interest by investing in portfolios through feeder/master funds), it could be seen that these is a direct investment relationship among feeder/master funds.