

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

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

BACKGROUND PAPER ISSUES # 9 AND 11

SPECIAL PURPOSE ENTITIES

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Background paper on Special Purpose Entities

I. Introduction

Special Purpose Entities (SPEs) are, for the time being, not defined in the international guidelines. Nevertheless SPEs can be described as entities:

- a) hosted in an economy other than the economy in which the parent company resides;
- b) without strong links with the host economy;
- c) involved in group financing or holding activities;
- d) hosted in an economy because of the fiscal regimes and advantages in the host economy or in the country of the parent company;
- e) and finally with a very limited role of management in the daily activities.

A variety of issues regarding the statistical treatment of SPEs, like residency, inclusion of the transactions and positions in direct investment data, institutional unit and institutional sector, are subject of discussion in the Balance of Payments Technical Experts Group (BOPTTEG) and Direct Investment Technical Experts Group (DITEG). This background paper has been prepared within the framework of DITEG. The subjects of this paper are the statistical treatment of SPEs in the Netherlands and the need for a separate treatment of the transactions of these entities.

II. Dutch Special Financial Institutions

Special Purpose Entities or, as they are called in the Netherlands, Special Financial Institutions (SFIs) are in the Netherlands established companies or institutions, regardless their legal form, whose shares are directly or indirectly held by non-residents and are mainly dealing with receiving funds from non-residents and channelling them to non-residents. SFIs may also be involved in managing participations outside the Netherlands on behalf of the parent company. There are three conditions that should be met by an entity to be considered an SFI:

- a) the entity should be a resident;
- b) the shares should be directly or indirectly in hands of non-residents;
- c) and the funds should be mainly raised from non-residents and handed over to non-residents.

All SFIs established in the Netherlands are considered as residents. By the end of 2003 over 9,000 SFIs were registered at De Nederlandsche Bank (DNB). In the Netherlands, the concepts of *shell companies* and *offshore enterprises* are not defined and consequently they are considered as residents.

In the Netherlands, SFIs have other reporting obligations than non-SFIs. Whilst SFIs only have to report transactions on a monthly basis, non-SFIs are obligated to report on a fully reconciled statement of positions and transactions for each Balance of payments item separately (Except for the reporting of FDI-capital participations). A fully reconciled statement including positions is reported by the SFIs once a year only. A significant part of SFIs not being selected as reporters, report their annual positions through the annual benchmark reporting. This group represent some 10% of financial transactions of all SFIs. This benchmark serves firstly as a basis for updating the population of *reporters* and secondly as a source for levelling up the SFI-statistics to annual totals.

III. Types of Dutch SFIs

Depending on their activities, in the Netherlands three types of SFIs can be distinguished.

- *Financing companies* are engaged in taking up and on-lending funds within and outside their own group companies almost entirely outside the Netherlands at the international capital market. These SFIs channel these funds mainly to their own group companies outside the Netherlands.
- *(Sub-) Holding companies* manage the participations outside the Netherlands, distribute dividends gained from these participations to their parent companies and perform acquisitions on behalf of their parent companies. Considering their high investment positions, the relative share of these enterprises in the IIP statistics is much higher than in the balance of payments statistics.
- *Royalty and Film right companies* concern a limited number of SFIs with a small share in the total transactions and positions of SFIs. They exploit the licences, patents and film rights for their parent companies or shareholders.

Beside these three main types, different varieties of SFIs can be distinguished as a combination of two or more of the above mentioned types. Considering the magnitude of their cross-border transactions the financing companies are the largest type of SFIs, followed by holding companies.

IV. Separate identification of SPE

With regard to the activities of SFIs, the Netherlands can be considered as a transit country for their transactions. In principle, the net outcome of the incoming and outgoing transactions should be equal or close to zero. This should be the case for each individual SFI as well as for the total of the transactions of the whole population of SFIs. In practice, however, a small net outcome may result for limited periods of time, mainly due to time differences.

There are currently two reasons to exclude the SFI transactions and positions in the national balance of payments and the IIP. First, the transactions of these entities are hardly linked with the Dutch economy and consequently almost irrelevant for the Netherlands. Second, including these transactions would blow up the balance of payments and the IIP figures, thereby hampering the analysis of the development of the external sector. For the same reasons SFI-transactions are, for the time being, not included in the National Accounts compiled by Statistics Netherlands.

To give an impression of the magnitude of the SFI transactions relatively to the non-SFI transactions, the balance of payments of the Netherlands for 2003 including SFIs is presented in the table below. Especially direct investment data of SFIs blow up the figures; they are even higher than non-SFI direct investments. The inclusion of the SFI data in direct investment means an increase of some 140% to 180%. A similar effect can be caused by inclusion of the SFI data in the IIP. The exclusion of the transactions and positions of SFIs results in the so-called “cleaning” of the Dutch balance of payments and the IIP, for the sake of analytical value of these statistics at national level.

As other countries do include SFI transactions from and to the Netherlands in their Balance of payments as, respectively, inward and outward *Direct Investment (and Portfolio Investment)*, the regularly published data by DNB of bilateral investment flows from and to the Netherlands cannot be compared with the investment statistics compiled in other countries. This comparability problem occurs also between the IIP published by DNB and the IIP published by the rest of the world. Considering the magnitude of the transactions and positions of the SFIs and their share in

the cross border financial activities, it is important to avoid discrepancies in different sets of data published by different compilers. Inclusion of the SFI data in the balance of payments and the IIP reported to the international organisations seems to be the solution for this problem.

Balance of Payments of the Netherlands in 2003			
EUR million			
	<u>Non-SFI</u>	<u>SFI</u>	<u>Total</u>
Balance on goods	23,220	0	23,220
Balance on services	-973	-268	-1,241
Received income	41,634	38,473	80,107
Expended income	<u>43,783</u>	<u>38,205</u>	<u>81,988</u>
Balance on income	-2,149	268	-1,881
Balance on current transfers	-6,850	0	-6,850
Balance on current account	13,245	0	13,245
Balance of capital transfers account	-1,879	0	-1,879
Direct investment abroad	-31,979	-44,933	-75,752
Direct investment in the Netherlands	<u>17,432</u>	<u>32,663</u>	<u>43,607</u>
Net direct investment	-14,546	-12,270	-32,144
Foreign securities	-50,249	36	-50,213
Dutch securities	<u>74,208</u>	<u>24,384</u>	<u>98,592</u>
Net portfolio investment	23,960	24,420	48,380
Assets	111,133	2,571	113,704
Liabilities	<u>-111,673</u>	<u>-1,986</u>	<u>-113,659</u>
Net financial derivatives	-537	585	48
Assets	-57,555	-18,183	-75,727
Liabilities	<u>29,704</u>	<u>9,502</u>	<u>39,580</u>
Net other investment	-27,853	-8,681	-36,149
Net financial account excluding official reserves	-18,979	-4,056	-19,868

To enable the ECB to compile the balance of payments and the IIP for the Euro-area, DNB reports data including transactions and positions of SFIs to the ECB. However, DNB is intending to include the SFI statistics in the reported balance of payments and IIP data to other international organisations like EUROSTAT and the OECD, enabling them to compile data for the EU and the OECD. Besides this intention of DNB, Statistics Netherlands is also intending to include the SFI transactions in the National Accounts.

Summing up it may be said that on one hand it is desirable to exclude the SFI data from the national external statistics because of the analytical usefulness. On the other hand it is unavoidable to include the SFI data in the reported balance of payments and the IIP data to international organisations, for the sake of consolidation of data of the Euro/EU-area and compilation of internationally comparable data.

V. Conclusion

Considering the magnitude of the activities of SPEs in/from some economies in the world, the transactions and positions of these entities should be included in external sector statistics like balance of payments and IIP, without netting out the incoming and outgoing transactions and positions. This inclusion is also due to the compilation of international comparable statistics and to avoid possible discrepancies in the statistics published by different countries. At the same time, the analytical value of the statistics should be safeguarded by avoiding the blowing up of the data, as a result of the inclusion of SPE data in an unrecognisable way. In this regard the following two options for the compilation of SPE data can be proposed:

- Compiling two sets of data; one including and one excluding the transactions and positions of SPEs.
- Including the SPE data in the existing sets of data but as a separately identifiable institutional sub-sector.

Furthermore the absence of a definition for SPEs in international guidelines could be an obstacle in the separate identification of SPEs and their transactions and positions. Considering the importance of compilation of international comparable statistics, the need for a harmonised and generally accepted definition in the new international guidelines like the BPM6 and the OECD Benchmark Definition is obvious. Such a definition should at least contain the main characteristics of SPEs; for example no or limited physical presence and no employees in the host country, no or limited links with the host economy and residency in an economy other than the economy of the parent company.