Direct Investment Technical Expert Group (DITEG)

Outcome Paper (DITEG) # 21

February 9, 2005

1. **Topic** : Various special cases – banking activities

2. **Issues** : see DITEG issue paper # 21 by Belgium

The paper tackled the specific case of transactions (and positions) of the banking sector with affiliated enterprises and proposed to treat this case as an exception on the principle ruling the transactions between entities of the following institutional sectors.

- other depositary corporations
- other financial intermediaries
- financial auxiliaries

as defined in the 1993 SNA.

Three options were introduced to attempt to take on board the specifics of the banking sector's activities and to simplify the treatment by a uniform approach of the activity of the sector :

- all transactions with affiliated banks be considered direct investment;
- all transactions other than those related to equity capital and permanent debt with affiliated enterprises (whether financial or nonfinancial) to be excluded from FDI transactions;
- introduction of a status of "captive bank" (along the lines of an intra-group financier) which is only active within a group of affiliated enterprises. Transactions of the captive bank with the rest of the group would be treated as direct investment, but transactions of other banks would be excluded from direct investment.

3. **Recommendation**

(i) In considering option #2 (i.e., full exclusion of transactions with affiliated banks, except permanent debt and equity, even by nonfinancial enterprises), the Group asked that this outcome paper clarify rationales for the existing international standards (under which FI-to-FI transactions (except permanent debt and equity) are excluded from direct investment and FI-to-nonFI transactions are included in direct investment).

In consideration of this request, the following rationales are offered. It should be recognized that other or different rationales may be important. Looking first at the exclusion from direct investment of FI-to-FI transactions (except permanent debt and equity), the rationale for this standard is related to the fact that banks, security brokers, and other financial intermediaries often move around huge sums of money, and the fact that these transactions may occur between affiliated financial intermediaries is an insufficient rationale for including these transactions in direct investment. Stated from a different perspective, if these large debt transactions were instead included in direct investment, they would be unlike, and substantially larger than, other debt flows classified in direct investment. On the other hand, these debt flows have much in common with flows that are between unrelated parties and that are now classified in portfolio or in other investment. To facilitate the needs of policymakers and other users of the BOP accounts, these FI-to-FI flows belong outside of direct investment.

Looking next at the inclusion in direct investment of FI-to-nonFI transactions, the rationale is related to the fact that multinationals routinely establish FIs as integral parts of their international operations, and that an incomplete and misleading picture of direct investment transactions would emerge if (contrary to existing standards) nonpermanent debt transactions of nonFIs with these FIs were excluded from direct investment. To illustrate, assume that a direct investor borrows funds from its financial DIE and onlends or invests those funds in a different foreign affiliate. The exclusion from direct investment of the direct investor's borrowings from its foreign affiliate that is an FI -- combined with the inclusion in direct investment of the direct investor's subsequent onlending or investment of those funds with a different direct investment enterprise -- would result in an incomplete or misleading picture of the impact of MNCs.[1]

4. **Rejected alternatives**

Options #1 and #3 (i.e. inclusion of all transactions between banks and affiliated enterprises in FDI transactions or a mixed approach introducing the notion of "captive bank" as a bank part of a group of enterprises and with activities restricted to the group) were rejected.

5. Questions for the IMF BOPCOM and the OECD WIIS will be formulated after the March 2005 DITEG meeting.

To be considered at the meeting of DITEG in March.

[1] It must be recognized that several members of DITEG have previously described their concerns about the inclusion in direct investment of certain FI-to-nonFI debt transactions. For example, the United States has described its concerns about inclusion in direct investment of transactions by U.S. parent companies with foreign affiliates established in the Netherlands Antilles for tax minimization purposes. The rationales offered here are believed to reflect circumstances that were prevalent when the existing standards were issued, and they may or may not reflect present day circumstances.