I. DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)
II. OUTCOME PAPER (DITEG) # 11-B

April 8, 2005

1. Topic: SPEs: Inclusion in direct investment of transactions between non-financial DIE and affiliated financial SPE

2. Issues: See DITEG Issue Paper # 11 by the ECB (December 2004); Background document by the ECB (February 2005); Background document by the OECD (February 2005); Background document by the Netherlands (DNB - March 2005)

3. Recommendations:

(i) DITEG confirmed the opinion expressed in previous meetings with regard to the fact that an internationally agreed definition of SPEs seems hardly achievable in the time set for updating BPM5 and the Benchmark Definition. This was reinforced by the background paper presented by the OECD, which showed a very large number of heterogeneous country practices and non-existence of any legal or other definition in most OECD countries. Therefore, the group was supportive to providing solutions to users' requests spelled out in the letter by the Chairman of the OECD Investment Committee by making use of standard principles consistent with the overall b.o.p. / i.i.p. framework, as opposed to developing any ad-hoc treatment addressed to a specific type of companies (i.e. SPEs), which is not separately identified in international statistical standards at present.

(ii) DITEG concurred with the view that a single solution could not address all problems related to the operations of SPEs. In particular, the group agreed with the three statistical problems identified by the ECB paper in the field of FDI:

- *First problem*: countries which are hosts of SPEs register a large volume of gross (inward and outward) flows and stocks due to the operations of SPE holding companies;

- *Second problem*: investor and investee countries are losing information on the final destination / ultimate origin of direct investment relationships passing through SPEs located in third countries; and

- *Third problem*: a number of distortions are registered in relation to FDI other capital flows and stocks due to the existence of conduits and SPVs raising funds in offshore centres for their direct investors.

(iii) With regard to the first problem, there was a wide range of views among the group, some supportive to leaving methodology unchanged, some supportive to isolating the operations of resident SPE holding companies as part of the standard components of the b.o.p. and i.i.p., and some supportive to presenting this information in supplementary presentations of FDI statistics. However, the impossibility to achieve an internationally agreed definition of SPEs (see (i) above) suggests that other possibilities should be explored. In that context, the possibility of isolating holding companies' transactions / positions (even if indistinguishably comprising both SPE and non-SPE holding companies) as part of the sector breakdown of the b.o.p. / i.i.p. - as suggested by BOPTEG outcome paper #9B – was considered by some as an approach which could be a more promising and feasible way out in this context (see also DITEG outcome paper #27).

(iv) Concerning the second problem, DITEG agreed with the proposal in the ECB paper that it should be resolved outside the scope of the core accounts, in particular via supplementary presentations of FDI statistics based on concepts other than the general b.o.p./i.i.p. standard ones. Since such concepts would have much to be with the identification of ultimate beneficial owners and affiliates, it was agreed to link their resolution to discussions related to these topics (see DITEG outcome paper # 12).

(v) Regarding the third problem, DITEG recognized that, on theoretical grounds, exclusions from FDI should be limited to financial SPEs borrowing funds from outside the group and lending to the direct investor, as suggested by the annotated outline of the forthcoming Balance of Payments Manual. On pragmatic grounds though, it was recognized that an accurate identification of the population of SPEs that would be subject to this exclusion would be hardly feasible (see DITEG outcome paper # 11); additionally, the difficulty to establish a perfect correspondence between origin and destination of each individual flow / stock (with a view to determining which of the loans provided by such SPEs would originate from outside the group) was also considered hardly realistic. Therefore, as an alternative it was proposed to exclude from FDI those reverse investments (other than equity capital and permanent debt) in which the lender is a financial affiliate providing funds to its (financial or non-financial) direct investor. While it was recognized that there was still some risk of excluding some transactions / positions which could be deemed to correspond to genuine FDI relations (FDI classified according to ultimate destination), it was concluded that the bulk of those excluded would not comply with the definition of FDI and, therefore, the quality, in particular the value for analysis, of FDI flows and stocks would significantly improve.

(vi) Finally, DITEG also expressed preference for maintaining the existing exclusion from FDI in the present standards, i.e. financing flows or stocks other than equity capital and permanent debt[1] in which both lender and borrower affiliated enterprises have a financial nature would be recorded under portfolio or other investment (instead of under FDI).

(vii) DITEG did not reach a consensus and was not in a position to determine the methodology in response to the request of the OECD Investment Committee to include in the *Benchmark Definition* recommendations to isolate "genuine FDI further broken down by partner country and by industry classification." As the balance of payments does not address specifically bilateral data issues, DITEG recommended to defer the

1. See also outcome papers #14 Permanent Debt and #21 Banking.

discussion to Benchmark Advisory Group of the OECD Workshop on International Investment Statistics.

4. Rejected Alternatives:

(i) The group rejected the proposal of the Netherlands to net out under inward direct investment all flows/stocks in which the resident company is not the ultimate beneficial owner. Among the reasons given, several members mentioned inconsistency with the reformulation of the directional principle as supported by DITEG, incompatibility with the general principle of recording gross assets and liabilities, serious consistency problems between inward and outward FDI which would prevent bilateral comparisons amongst countries, etc. In general, it was deemed that the proposal would create as many problems as it would solve. However, the group was of the view that some of the ideas contained in the paper could find proper accommodation in supplementary presentations of FDI statistics and suggested further work in that direction.

5. Questions for the IMF Committee on Balance of Payments (the Committee) and the OECD Workshop in International Investment Statistics (WIIS)

(i) Do the Committee and the WIIS agree that solutions to users' requests concerning SPEs should be provided by making use of standard principles consistent with the overall b.o.p. / i.i.p. framework?

(ii) Do the Committee and the WIIS agree that a single solution could not address all problems related to the operations of SPEs?

(iii) If yes, do the Committee and the WIIS agree with the three main statistical problems in the field of FDI identified by DITEG, namely (1) large volume of gross (inward and outward) flows and stocks due to the operations of SPE holding companies in countries which are SPE hosts; (2) loss of information on the final destination / ultimate origin of direct investments passing through SPEs located in third countries; and (3) how to record financial flows / stocks due to the existence of conduits and SPVs raising funds in offshore centres for their direct investors.

(iv) In relation to the first problem, do the Committee and the WIIS agree that the possibility of isolating holding companies' transactions / positions (even if indistinguishably comprising both SPE and non-SPE holding companies) as part of the sector breakdown of the b.o.p. / i.i.p. could be worth considering?

(v) In relation to the second problem, do the Committee and the WIIS agree that it should be resolved outside the scope of the core accounts and in particular via supplementary presentations of FDI statistics based on, inter alia, UBO/UBA principles?

(vi) In relation to the third problem, do the Committee and the WIIS agree that the most practical solution is to exclude from FDI those reverse investments (other than equity capital and permanent debt) in which the lender is a financial affiliate providing funds to its (financial or non-financial) direct investor?

(vii) Do the Committee and the WIIS agree to disregard the proposal to net out under inward direct investment all flows/stocks in which the resident company is not the ultimate beneficial owner? Do both committees agree that the proposal could perhaps be given further consideration in developing supplementary presentations of FDI statistics?