I. DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)
II. OUTCOME PAPER (DITEG) # 14

April 8, 2005

1. Topic: Permanent debt between affiliated financial intermediaries

2. Issues: See DITEG Issue Paper # 14 by Japan (December 2004), the IMF (December 2004), and the United States (March 2005).

3. Recommendations:

(i) With the aim to harmonize international treatments of permanent debt between affiliated financial intermediaries, DITEG agreed that it was worth discussing and elaborating on alternative treatments and clarifying the statistical definition of permanent debt.

(ii) At the December 2004 meeting, a majority of members was of the opinion that, if a clear definition of permanent debt could be developed, then permanent debt between affiliated financial intermediaries should continue to be recorded under Direct Investment.

(iii) The December 2004 Outcome Paper # 14 (which summarized the discussion of the papers presented by Japan and the IMF) states:

> Some members pointed out that "debt that represents a permanent or lasting interest, in the form of subordinated and perpetual debt, that also has the purpose of acting as equity" (option (3) in the IMF issue paper) was appropriate for the statistical definition, and the regulatory definition (the BIS second-tier capital) might be a practical indication for compilers. However, a concern was mentioned that we had not been provided with the definition of BIS second-tier capital and therefore could not assess its practicality for use in defining direct investment. Also, it would be necessary to discuss further the issues pertaining to use of a regulatory definition (mainly aimed at promoting financial stability) for use in defining direct investment.

(iv) The United States offered to prepare a background paper for the March 2005 DITEG meeting that would provide the definition of BIS second-tier capital and assess its practicality for use in FDI statistics.

(v) DITEG discussed in March 2005 the paper presented by the United States and concluded that the Basle Tier 2 Capital definition was not appropriate for use as the definition of permanent debt between affiliated financial intermediaries, for reasons summarized in the background paper.

(vi) DITEG also concluded that all "unsecured and subordinated debt" should not be regarded as permanent debt. (The existing standards associate permanent debt with a permanent and lasting interest – such as debt used by branch banks for acquiring fixed assets – and “unsecured and subordinated debt” did not convey the same meaning or concept.)

(vii) DITEG concluded, mainly on practical grounds, that compilers should no longer define and include “permanent debt” in direct investment. A concern was that large bilateral asymmetries could continue to exist if individual compilers defined for themselves what constituted permanent debt. Instead, DITEG concluded that all debt between affiliated financial intermediaries should be excluded from direct investment.

4. Rejected Alternatives:

The existing international standard – which requires compilers to identify permanent debt between affiliated financial intermediaries and include such debt in Direct Investment -- was rejected.

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 the Basle definition of tier 2 capital is not appropriate for use as the definition of permanent capital between affiliated financial intermediaries?

(ii) Do the Committee and the WIIS agree that “unsecured and subordinated debt” is not the same concept as permanent debt, because the latter (but not the former) concept implies a permanent and lasting interest?

(iii) Do the Committee and the WIIS agree that compilers should no longer define and include “permanent debt” in direct investment, and that, instead, all debt between affiliated financial intermediaries should be excluded from direct investment?