I. DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)
II. OUTCOME PAPER (DITEG) # 21

April 8, 2005

1. Topic: Various special cases – banking entities

2. Issues: see DITEG issue paper # 21 by Belgium (November 2004)

3. Recommendation

(i) The paper proposed three alternatives to the way in which transactions and positions between banks and related enterprises might be treated. These are:

- Option #1: inclusion of all transactions between banks and affiliated enterprises in direct investment transactions and positions.
- Option #2: full exclusion of transactions with affiliated banks, except permanent debt and equity, even by nonfinancial enterprises; and
- Option #3: a mixed approach introducing the notion of "captive bank" (equivalent to an intra-group financier) as a bank, as part of a group of enterprises and with activities restricted to the group).

Generally, there was little support for the first and third options.

(ii) In considering option #2, the Group asked that this outcome paper clarify rationales for the existing international standards (under which financial institution-to-financial institution transactions and positions (except permanent debt and equity) are excluded from direct investment and financial institution-to-nonfinancial institution transactions and positions are included in direct investment).

(iii) 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 financial institutions-to-financial institutions transactions (except permanent debt and equity), the rationale for this standard is probably 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 financial institutions-to-financial institutions flows belong outside of direct investment.

(iv) Looking next at the inclusion in direct investment of financial institutions-to-non-financial institutions transactions, the rationale is related to the fact that multinationals routinely establish financial institutions as integral parts of their international operations, and that an incomplete and misleading picture of direct investment transactions and positions would emerge if (contrary to existing standards) non-permanent debt (and equity) transactions and positions of non-financial institutions with these financial institutions 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 financial institutions -- 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]

(v) The group did not support any change to the present treatment, as clarified in 2000, of transactions and positions between banks and their affiliated enterprises, other than the treatment of certain conduits (that loans by a financial affiliate to its non-financial parent should not be considered to be direct investment: as set out in outcome paper #11B) and permanent debt (that permanent debt between related financial affiliates should no longer be considered direct investment: see outcome paper #14). However, the question was raised whether consideration might be given to excluding from direct investment, deposit transactions and positions between banks and their non-financial affiliates.

4. Rejected alternatives

All options proposed in the paper were rejected, subject to consideration of deposits between banks and all affiliates.

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 present treatment of transactions and positions between banks and affiliated enterprises (both nonfinancial and

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[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.

financial) should remain unchanged, except in regard to the treatment of certain conduits and permanent debt?

(ii) Do the Committee and the WIIS agree that the Benchmark Advisory Group should examine the treatment of deposits by nonfinancial entities with affiliated banks, with a possible view of creating an additional exception to the "10 percent" rule?

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