I. DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)
II. OUTCOME PAPER (DITEG) # 30

April 8, 2005

1. Topic: Mutual funds (units, sectorization, residence, transactions)

2. Issues: See DITEG Issue Paper # 30 by Japan (November 2004); Background document by ECB (October 2004)

3. Recommendations:

(i) DITEG discussed the issue paper on whether there are circumstances when mutual funds, hedge funds, distressed funds, and feeder/master funds might be considered to be in direct investment relationships.

(ii) DITEG felt that the existing standards are less than clear, appear to conflict between direct investment and portfolio investment, and do not specify what sort of investment involving mutual funds should be classified to portfolio investment. The group felt that the wording in *BPM5* needed to be clarified for the new balance of payments manual.

(iii) The discussion revolved around what constituted "direct investment" and what, if any, exceptions there might be to the 10 percent equity ownership rule. The group felt that mutual funds, and similar collective investment schemes, were a rising international phenomenon, in particular, the growing importance of master/feeder funds (fund of funds), hedge funds and distressed funds.

(iv) DITEG felt that, in recommending that mutual funds should be included in portfolio investment, *BPM5* would appear to address only retail mutual funds. Generally, the group felt that, were the "10 percent" rule to be reached, investment in hedge funds and distressed funds should be considered to be direct investment.

(v) Regarding retail mutual funds, there were divided views. Some supported the application of the "10 percent" rule. Others felt that there was generally a different type of motivation for these type of funds: that there was no genuine interest in exerting influence on the management of the entity in which there might be more than 10 percent equity ownership. Accordingly, those of this opinion felt that investment in these types of mutual funds should be regarded as portfolio investment.

(vi) With regard to master/feeder funds, most members of DITEG felt that the "10 percent" rule should be applied. Others pointed out that were "feeders" to be treated as direct investors (should their ownership meet the "10 percent" rule for equity holding in the "master") this treatment would be an inversion of the standard direct investment relationship: the "feeders" would be direct investors even though the "master" would control them.

(vii) The group discussed how such funds might be identified, with some members proposing that industrial activity classification might be used.

4. Rejected Alternatives:

None

5. Questions for the Committee and the Workshop on International Investment Statistics

(i) Do the Committee and the WIIS agree, when mutual funds, hedge funds, and distressed funds have equity ownership in another entity of 10 percent or more, such relationships should be considered direct investment, or do they think that there may be some exceptions to the "10 percent" rule?

(ii) What are the views of the Committee and the WIIS on whether feeder funds should be treated as direct investors in their master funds, should they hold 10 percent or more of the equity in the master?

(iii) What are the views of the Committee and the WIIS if equity investment by mutual funds, hedge funds, etc. in a nonresident entity meets or exceeds 10 percent of equity on issue?

(iv) Do the Committee and the WIIS have any views on how these funds might be identified?

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