

IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS
BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTTEG)

ISSUES PAPER (BOPTTEG) # 9

SPECIAL PURPOSE ENTITIES AND HOLDING COMPANIES

Prepared by Robert Dippelsman, IMF Statistics Department

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BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP

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SPECIAL PURPOSE ENTITIES AND HOLDING COMPANIES

“Special purpose entities,” “special purpose vehicles,” “shell companies,” and “international business companies” (called “SPEs” in this paper, for brevity) are terms used in different ways; in this paper, they are used to cover legal structures that have little or no employment, operations, or physical presence in the jurisdiction in which they are created. They are typically used as devices to hold assets and liabilities, and do not undertake production. As legal devices, SPEs are relatively cheap to create and maintain while offering possible taxation, regulatory burden, and confidentiality benefits. Incorporation of SPEs are often associated with offshore financial centers but may also be found in other jurisdictions. Some holding companies are SPEs as defined in this paper.

Rather than attempt to reconcile the different terms and definitions in use, this paper discusses the activities in terms of four types of economic functions that are undertaken with SPEs, and thus to relate them to the existing institutional sector classification:

- **holding companies**, which are used to own subsidiaries (as in the example in the *Balance of Payments Textbook (BPT)* para. 543). Some holding companies are SPEs (such as those used for round tripping, see *Annotated Outline (AO)* paras. 5.21-22); others may have employees and physical operations;
- **vehicle companies**, which are used for securitization (see *Monetary and Financial Statistics Manual 2000 (MFSM 2000)* para. 100);
- **conduits**, i.e., raising funds on behalf of a parent (see *MFSM 2000* para. 72, *BPT* para. 544); and
- **SPEs for other asset management functions**, including holding business and family wealth, with or without liabilities (as in the example in *BPT* para. 543).

Some issues related to SPEs are not dealt with in *BPM5*, but have become increasingly significant in international transactions and positions.

I. Holding companies

A. Institutional units issues:

Current international standards for the statistical treatment of the issue:

- Holding companies are separate units according to *1993 SNA* paras. 4.37-39 and 4.100, without any mention of a requirement for physical presence or undertaking production. However, undertaking of production would seem to be required from discussions elsewhere (para. 4.23 states that corporations are defined as for the purpose of producing goods or services for the market).

- Holding companies are not covered in *BPM5*, but SPEs are assumed to be separate institutional units in *BPM5* para. 365.

Concerns/shortcomings of the current treatment:

- *BPM5* does not discuss holding companies specifically.

Possible alternative treatments:

- The manual could discuss holding companies specifically and state that they are separate units even if they do not have a physical presence or undertake production.

B. Institutional sector issues

Current international standards for the statistical treatment of the issue:

- A holding company should be classified by the predominant sector of the group of corporations it owns (*1993 SNA* para. 4.100).
- A holding company should be classified to other financial intermediaries subsector (*MFSM 2000* para. 100).

Concerns/shortcomings of the current treatment:

- *1993 SNA* and *MFSM 2000* seem to differ.
- The discussions do not refer to cases where the holding company is also itself a subsidiary.
- The predominant sector of a group of corporations may be hard to determine when members of the groups are in several different countries.
- The functions undertaken by the group as a whole seem less relevant if they are not undertaken in the economy of the holding company.
- A holding company may be part of two or more groups, making the *1993 SNA* definition possibly ambiguous.

Possible alternative treatments:

- The possibility of treating holding companies as a subsector of financial corporations in their own right is raised in *AO* para. 4.31(c). This would avoid the concerns noted, but might be considered strange if the holding company for a nonfinancial group was included in the financial sector.
- In the case of an economy where the cross-border activities of SPEs are significant relative to those of the rest of the economy, it may be desirable to show SPEs separately to identify their role and also to allow data to be shown on the operations of other enterprises in their own right. In such a case, SPEs could be shown as a supplementary item, along the lines of the proposal in *External Debt Statistics* para. 2.19. Two possibilities are that:
 - (i) the definition of SPEs could follow national legislative provisions; or
 - (ii) a consistent operational definition on an international basis could be developed.

C. Residence issues

Current international standards for the statistical treatment of the issue:

- Many holding companies have a physical presence, so the territory of residence is clear.
- Otherwise, *BPM5* defines residence of SPEs as being where they “are located” (para. 79).
- If there is little or no physical presence, the residence of a corporation is determined by place of incorporation or registration (*External Debt Guide* para. 2.18; *Coordinated Portfolio Investment Guide (CPISG2)* para. 3.9; corporations “normally expected” to be resident where it is created and registered *1993 SNA* para. 4.24(a)).

Concerns/shortcomings of the current treatment:

- The *BPM5* guideline for SPEs lacks clarity and has been interpreted in different ways. Its terms differ from other guidelines.
- The use of place of incorporation can result in a “P.O. Box Headquarters” being the source of investment rather than the location of substantial operations, e.g., in the recent “corporate inversion” cases in the U.S.

Possible alternative treatments:

- *AO* para. 4.45 proposes that incorporation or registration be used to determine residence of entities that have little or no physical presence.
- *AO* paras. 4.58(e) and 5.22 propose ultimate beneficial owner/destination as a possible supplementary (i.e., encouraged, but not required) basis for presentation of direct investment data, which can be seen as a way of “looking through” SPEs. Such supplementary data could be considered for positions and, with more difficulty, transactions. However, there are substantial difficulties in identifying the ultimate ownership when there are long chains, particularly involving ownership by multiple territories.

II. Vehicle companies

A. Institutional units issues

Current international standards for the statistical treatment of the issue:

- SPEs, including vehicles, are taken as separate institutional units in *BPM5* para. 365.
- Vehicle companies are separate entities (*MFSM 2000* para. 100).

No concerns/shortcomings of the current treatment identified.

B. Institutional sector issues

Current international standards for the statistical treatment of the issue:

- Vehicle companies are specifically included in other financial intermediaries in *MFSM 2000* para. 100 and seem to be within the general definitions of financial intermediation in other manuals.

No concerns/shortcomings of the current treatment identified.

C. Residence issues

As for holding companies.

III. Conduits

A. Institutional units issues

Current international standards for the statistical treatment of the issue:

- Conduits are implicitly recognized as separate institutional units by *BPM5* paras. 365 and 372.
- If created by a parent corporation, conduits appear to meet the definition of “ancillary corporations” (*1993 SNA* paras. 4.40-44), which are not separate institutional units, so should be combined with their owners. However, *MFSM 2000* says that an ancillary corporation that is resident “in a foreign country” is treated as a separate entity (para. 71).

Concerns/shortcomings of the current treatment:

- When the ancillary corporation is in a different jurisdiction to owners, the *1993 SNA* treatment is neither completely conceptually desirable (in that the ancillary is in many ways connected to the jurisdiction in which it was created) or practical.
- On the other hand, the *MFSM 2000* treatment would be unsatisfactory for analysts who wish to “look through” conduits, i.e., treat the flows as going directly rather than via a conduit. This is because partner data for transactions and positions involving SPEs hide the ultimate source/destination.
- The *MFSM 2000* guidance is incomplete if a conduit were owned by several enterprises, which were residents of different economies, some of which could include the economy in which the conduit is resident.

Possible alternative treatments:

- *AO* para. 4.22(c)-(d) proposes to follow and clarify the *MFSM* treatment by stating that an ancillary company is a separate entity if it is resident of a different territory from any of the entities it serves.

- *AO* para. 4.58(e) proposes ultimate beneficial owner/destination as a possible supplementary basis¹ for presentation of direct investment data. Extensions of that approach to portfolio and other investment could also be considered as possibilities. (Note: expressed in terms of the functional classification, the role of conduits is to transform portfolio and other investment flows to reverse direct investment.² Under the ultimate beneficial owner/destination concept, the transformation would not occur.)

B. Institutional sector issues

Current international standards for the statistical treatment of the issue:

- Conduits are classified as other financial intermediaries in *MFSM* para. 72.
- In the *BPM5* sector classification, all cases other than monetary authorities, banks and general government are classified to “other sectors.”
- In *BPT* para. 544, they are described as financial intermediaries.
- Since they are ancillary corporations, they are not institutional units and so do not need to be classified in the *1993 SNA*.

Concerns/shortcomings of the current treatment:

- The application of the concept of financial intermediation to the case of conduits is not clear:
 - Such activities would not be financial intermediation when the conduit is resident in the same territory as its owners. (Because an entity is an ancillary corporation, and not an institutional unit, it would, therefore, be merged with its owners.)
 - Financial intermediation involves dealing with financial markets for both fund-raising and funds-dispersal. However, for funds dispersal, the conduit is only dealing with affiliated enterprises.

Possible alternative treatments:

- *AO* para 4.30(g) proposes that conduits be classified as other financial intermediaries.
- As noted under holding companies above, SPEs could be shown separately, where their cross-border activities are significant relative to the rest of the economy.

¹ In the new manual, a distinction will be made between memorandum and supplementary items. Memorandum items are considered as a part of the standard components whereas supplementary items are raised as options that may be considered when a particular issue is of interest to analysts and policy makers.

² A related issue is whether transactions and positions between enterprises that are not financial intermediaries and affiliated conduits or other SPEs should be classified as direct investment—see *AO* para. 5.27(b) and DITEG Issues Paper 7/8.

C. Residence issues

As for holding companies.

IV. SPEs for other asset management functions

A. Institutional units issues

Current international standards for the statistical treatment of the issue:

- SPEs in general are assumed to be separate institutional units in *BPM5* para. 365.
- These entities are not discussed in the *1993 SNA*. Possibly they are assumed not to be separate units and combined with their owners.

Concerns/shortcomings of the current treatment:

- If these SPEs are considered artificial, partner data for transactions and positions involving SPEs do not show the ultimate source/destination.
- Combining these SPEs with their owners may not be practical if the units are resident in different territories to its owners, nor will it reflect the connections of the SPE to the territory in which it was created. As well, the owners may also be in more than one territory and/or sectors.

Possible alternative treatments:

- *AO* para. 4.22(d)-(e) proposes that such companies should be treated as separate institutional units if they are resident of a different territory from any of the entities they are owned by.
- If SPEs are considered artificial legal structures, they could be “looked through,” i.e., the owners of the entity would be treated as if they undertook the transactions and held the positions directly. However, the information to do so may be difficult or impossible to obtain in many cases.

B. Institutional sector issues

Current international standards for the statistical treatment of the issue:

- In the *BPM5* sector classification, these functions can be classified to “other sectors.”
- These SPEs have no obvious institutional sector in the *1993 SNA/MFSM 2000* classification, possibly because the *1993 SNA* assumed that such entities would be in the same countries as their owner and therefore able to be combined with the owning institutional unit.

Concerns/shortcomings of the current treatment:

- While the previously discussed cases of SPEs undertake economic functions that are covered by existing sector categories, these SPEs fit no obvious institutional sector (see also *AO* para. 4.31(b)).

Possible alternative treatments:

- AO asks whether entities for holding and managing wealth, which includes some SPEs, should be classified as other financial auxiliaries or need their own sector or subsector (paras. 4.30(f) and 4.31(b)).
- As noted under holding companies above, SPEs could be shown separately, their cross-border activities are significant relative to the rest of the economy.

C. Residence issues

As for holding companies.

IV. Points for Discussion

Institutional units:

(1) Does the group agree that all SPEs should be separate institutional units when the SPEs are in a different economic territory to that of their owners?

Institutional sector (based on 1993 SNA/MFSM 2000 classifications):

(2) How should holding companies be classified as to institutional sector?

(3) How should other wealth management SPEs be classified as to institutional sector?

(4) Can a standard definition of SPEs be developed that would allow them to be identified in an internationally standard way?

Residence:

(5) Should territory of incorporation or registration be adopted to determine the residence of entities that have little or no physical presence?

(6) Does the group support the AO proposal for supplementary data on ultimate beneficial owner/ultimate destination for direct investment? Should this proposal be extended to other cases?

References

BPM5, Chapters IV, XVIII

Balance of Payments Textbook, Chapter IX

1993 SNA, Chapter IV

Annotated Outline, Chapter 4

Coordinated Portfolio Investment Guide, second edition, Chapter 3

External Debt Statistics: Guide for Compilers and Users, Chapter 2

Monetary and Financial Statistics Manual 2000, Chapter 3

Note on the Application of the Residence Concept to Small Economies with International Financial Centers ([BOPCOM-01/13](#))

Exploring the Borderline Between Direct Investment and Other Types of Investment: The U.S. Treatment ([BOPCOM-02/35](#))

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IMF Background Paper, *Offshore Financial Centers*, 2000.