

IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS
DIRECT INVESTMENT TECHNICAL EXPERT GROUP

BACKGROUND PAPER (DITEG) # 9

DEFINITION OF SPECIAL PURPOSE ENTITIES

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Background paper: Definition of Special Purpose Entities

Considering the significant share of cross border transactions and positions of Special Purpose Entities (SPEs) in external statistics, the attention for the statistical treatment of these entities has been growing over the past decade. In the framework of the revision of the Balance of Payments Manual some papers have been presented in both DITEG and BOPTTEG about residency, sector classification and general statistical issues related to SPEs (issue papers #9 and #11); in order to clarify whether or not, and if so, how to include the data of these entities in the IIP and balance of payments. Nevertheless, in present international guidelines a definition of the concept of SPE does not exist. It is imaginable that in the new BPM specific guidelines for the statistical treatment of SPEs will be introduced, which may not be easy to apply in absence of a definition for these entities. As a consequence of different definitions of SPEs used at a bilateral and global level by national compilers, asymmetries may appear. In other words in the absence of a definition, the harmonisation of the statistical treatment of SPEs will not result in eliminating asymmetries between the national statistics, when they are aggregated and consolidated at a multi-country level. The concept of SPE is interpreted in different ways in different jurisdictions, which makes the introduction of a generally accepted definition of SPEs difficult. Nevertheless, this paper is a first attempt to come closer to a common understanding of the concept of SPE and to create a generally accepted definition of SPEs.

I. Current international standards

In the present international guidelines the concept of SPE has not really been defined.

However, in some guidelines the term SPE has been used and described.

BPM5 refers to the term SPE within the framework of direct investment. In paragraph 365 different kinds of SPEs like holding companies, base companies or regional headquarters and also different types of activities of SPEs like administration, management of foreign exchange risk or facilitating the financing of investments are mentioned. Furthermore according to the Manual SPEs are “integral part of the structure of direct investment” and their transactions are mainly performed within their own group of companies.

Paragraph 542 of the Balance of Payments Textbook describes SPEs as entities “(1) generally organized or established in economies other than those in which the parent companies are resident and (2) engaged primarily in international transactions but in few or no local operations”.

The OECD Benchmark Definition of Direct Investment refers to SPEs as entities “which facilitate financing of investments for the group from sources both internal and external to the multinational enterprises”. These entities are also engaged in “sale, regional administration including management of foreign exchange risks and other activities aimed at profit maximisation” (paragraph 70).

The SNA does not contain any definition or description of SPEs. Only in the context of the residency of the offshore units a reference is made to the so called “special purpose units” (paragraph 14.24).

II. Shortcomings of the current treatment

None of the present international guidelines provides such a clarification that the concept of SPE could unambiguously be interpreted and applied. Although not contradictory, the above-mentioned paragraphs contain limited general descriptions and indications of SPEs only. Furthermore, considering the possible introduction of a specific treatment of SPEs in the new Manual, it is desirable to approach SPEs as a general issue in external statistics and not only relevant in the context of FDI for the following reasons: Firstly, at the moment it is not clear to what extent in the new Manual transactions and positions of SPEs will be included in the FDI statistics. Secondly, SPEs are considered as “autonomous institutional units” which implies that, for statistical treatment, they are separated from their parent companies. Finally, the sector and industry classification and the residency of SPEs, are beyond the concept of FDI, which is discussed in DITEG and BOPTEG.

All in all, the need for clear guidance on the statistical treatment of SPEs, including a definition within the general BOP framework is desirable.

III. Possible alternative treatment

SPEs are legal entities created and used by multinational companies for particular purposes. SPEs have wide range of activities like finance, managing subsidiaries, holding financial assets and liabilities, securitisation of assets, cash management, managing royalty's and film rights and other asset management activities. For creating a definition of SPEs different criteria could be used based on:

- a) structure,
- b) purpose,
- c) type of activities,
- d) and links with the host economy.

In the framework of the preparation of the OFI statistics and the statistical treatment of Special Purpose Vehicles (SPVs) the European System of Central Banks (ESCB) recommends to specify the sub-sector Other Financial Intermediaries, except insurance corporations and pension funds (OFIs) (S123) by dividing them into the following groupings:

- a) Investment funds (IFs)
- b) Financial vehicle corporations created to be the holders of securitised assets (FVCs)
- c) Financial corporations engaged in lending (FCLs)
- d) financial holding corporations (FHCs)
- e) Security and derivative dealers (SDDs)
- f) And “other” OFIs which contains all other OFIs not covered by the above-mentioned groupings.

The first five groupings are not only described by the ESCB but also defined. Nearly all SPEs in the external statistics can be categorised under OFIs. In the ESCB categorisation, SPEs could be placed in all the groupings except IFs, but the main part of SPEs could be divided into the grouping of “other OFIs”. Unfortunately the category to which most SPEs should be allocated is a rest category and is not defined or even described.

Some international organisations and national compilers have attempted to define or describe SPEs or SPE-like entities. The Netherlands has a legal definition for the so called Special Financial Institutions (SFIs), which are almost synonymous to SPEs. SFIs are defined as in the Netherlands established companies or institutions, regardless of their legal form, whose shares are directly or indirectly held by non-residents and are mainly dealing with receiving funds from non-residents and channelling them to other non-residents. This definition is based on the links of the entities to the host economy and their ownership. Dutch SFIs are identified and registered separately from other entities for their statistical treatment. SPEs in Denmark are defined as holding companies, which do not interact with the local economy and have hardly any employees.

In absence of a definition in the international guidelines, an overview of the features of these entities may be helpful in taking some steps towards the creation of a common understanding of the concept of SPE. The general characteristics of SPEs can be summarised as follows:

- SPEs are legal entities,
- SPEs are a part of a multinational group (company),
- SPEs are hosted in a different country than their parent companies and are separate institutional units,
- SPEs are established for the cost minimisation and tax planning of their own group company,
- SPEs are usually established to take advantage of legal and fiscal regimes in different jurisdictions, rather than real economic incentives in the host economy,
- SPEs perform activities on behalf of, by order of, or on expense of their parent companies,
- SPEs have no or limited links with the economy in which they are hosted,
- SPEs have no or limited physical presence in the host economy,
- SPEs have little or no employees in the host economy,
- SPEs are not engaged in production of manufacturing, services etc. in the host economy,

- SPEs may finance activities of their own group companies by raising and distributing funds within and from outside the group,
- SPEs may be engaged in cash management activities,
- SPEs may hold subsidiaries (mainly outside the host economy),
- SPEs may be engaged in securitisation,
- SPEs may exploit royalties and film rights.

Some of these features of SPEs refer to the type, some to the structure and finally some to the (non-existence of) links of these entities with the host economies. This categorisation of the features of SPEs can be summarised according to the following dimensions:

Types	Structure/purpose	Links with the host economy
+ Financing companies/conduits	+ Autonomous legal entities	+ No or limited links
+ Holding companies	+ Part of a group company	+ No or limited physical presence
+ Asset securitisation vehicles	+ Not hosted in the economy of the parent	+ No or few employees
+ Asset management companies	+ Tax planning and cost minimisation	+ Not engaged in production
+ Distribution and sale companies	+ Operating on behalf of the parent	
+ Royalty and film right companies		

The question at this stage is which (category) of the features should be decisive in order to set a definition for SPEs. On first thoughts and in order to avoid misinterpretations it seems logical to cover all the three categories in the definition. In this case the following proposal may serve as a first attempt in defining SPEs:

SPEs are autonomous legal entities, directly or indirectly wholly foreign owned, that are part of a group company, without substantial real economic links with the host economy, engaged in a variety of cross-border financial activities, which are aimed at the passing through of all types of financial and non-financial assets, liabilities and related income to third countries.

Of course there are further questions and discussion points that should be answered or discussed before a definition for SPEs can be determined.

IV. Points for discussion

- i) Do DITEG members subscribe to the need for the creation of an SPE definition in the international guidelines?*
- ii) Do DITEG members consider the creation of an SPE definition by combining the presented features attainable?*
- iii) Do DITEG members subscribe to the features of SPEs presented above? Are there features missing? Are there features presented, which do not reflect SPEs in the external statistics?*
- iv) Do DITEG members think the features presented need additional clarification? Should these features be given even weight in the determination of a definition?*
- v) Do DITEG members agree that Royalty and Film Right companies should also be considered SPEs?*
- vi) Assuming that in the new Manual separate guidelines will be introduced for statistical treatment of SPEs: Do DITEG members think that the proposed definition is applicable by all compilers, including the compilers of the countries of the counterparties?*

VI. References

Annotated Outline for the Revision of BPM5, Paragraphs 5.21.

Balance of Payment Manual, fifth edition, Paragraph 365.

Balance of Payments Textbook, Paragraph 542.

OECD Benchmark Definition of Foreign Direct Investment, third edition, Paragraph 70.

Special Purpose Entities and Holding Companies, Issue Paper (BOPTTEG) # 9, prepared by Robert Dippelsman, IMF Statistics Department.

Statistical treatment of Special Purpose Vehicles and related issues, ECB (STC/SDC/SPVS)

Foreign Direct Investment; Task Force Report, ECB, March 2004.