BOPCOM-05/49

Eighteenth Meeting of the
IMF Committee on Balance of Payments Statistics
Washington, D.C., June 27–July 1, 2005

Permanent Debt

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 background paper by 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?

IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS AND OECD WORKSHOP ON INTERNATIONAL INVESTMENT STATISTICS

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

ISSUES PAPER (DITEG) #14

PERMANENT DEBT BETWEEN AFFILIATED FINANCIAL INTERMEDIARIES

Prepared by Marie Montanjees, IMF Statistics Department

November 2004

DIRECT INVESTMENT TECHNICAL EXPERT GROUP

ISSUES PAPER (DITEG) #14: PERMANENT DEBT BETWEEN AFFILIATED FINANCIAL INTERMEDIARIES

I. Current international standards for the statistical treatment of the issue

1. The fifth edition of the IMF *Balance of Payments Manual (BPM5)* indicates that "intercompany transactions between affiliated banks (depository institutions) and affiliated financial intermediaries (e.g. security dealers)—including [Special Purpose Entities] SPEs with the sole purpose of serving as financial intermediaries—recorded under direct investment capital transactions are limited to those transactions associated with permanent debt (loan capital representing a permanent interest) and equity (share) capital, or in the case of branches, fixed assets. Deposits and other claims and liabilities related to usual banking transactions of depository institutions and claims and liabilities of other financial intermediaries as classified, as appropriate, under portfolio investment or other investment." (Paragraph 372.)

2. The third edition of the OECD *Benchmark Definition of Foreign Direct Investment (BD3)* states that "in the case of banks, all intercompany flows – with the exception of those considered to represent permanent debt or equities – with related affiliates should not be counted as direct investment. Similar considerations apply to financial intermediaries... and to SPEs whose sole purpose is to serve as financial intermediaries. OECD recommends that intercompany flows between affiliated entities involved in these activities be excluded from direct investment. (Paragraph 40.) Although the *BD3* defines permanent debt simply as "representing a permanent interest" (paragraph 61), a footnote indicates that "[Bank of International Settlements] BIS "second-tier" capital might be a useful indication for compilers regarding what represents permanent debt."

3. The *Balance of Payments Textbook (BOP Textbook)* (paragraphs 542-544) specifically excludes from the direct investment data all non-equity/permanent debt transactions between a nonfinancial enterprise and an affiliated SPE with the sole purpose of financial intermediation, and specifically includes such transactions between a nonfinancial enterprise and an affiliated SPE with the primary purpose of financial intermediation

4. These statements have caused confusion in the past, for a number of reasons:

(a) The *BPM5* text could be interpreted as applying only to those transactions between affiliated banks and between affiliated financial intermediaries, and not to transactions between affiliated banks and affiliated financial intermediaries.

(b) The *BD3* text which refers to intercompany flows with related affiliates could be interpreted as referring to all related enterprises, including nonfinancial enterprises, and not just to those that are banks or financial intermediaries.

(c) Neither the *BPM5* or the BD3, or the *BOP Textbook* were clear about what exactly was meant by financial intermediaries.

(d) There seemed to be little justification for the differing treatment of SPEs with the sole purpose of financial intermediation and those with the primary purpose of financial intermediation, given that there is essentially no economic difference between the two types of SPEs.

5. As a result, following discussions with the relevant working groups at the OECD and the ECB, at its October 2001 meeting the IMF's Committee on Balance of Payments Statistics (the Committee) amended the treatment recommended in the international manuals. The decision affecting the treatment of permanent debt, which was promulgated in May 2002 in the document *Recommended Treatment of Selected Direct Investment Transactions*, was as follows: "The *BPM5* definition of the scope of enterprises included under "banks and other financial intermediaries such as security dealers" should be clarified as being equivalent to the following *SNA93* financial corporations sub-sectors: other depository corporations (other than the central bank); other financial intermediaries, except insurance corporations and pension funds; and financial auxiliaries. As a result, SPEs principally engaged in financial intermediation for a group of related enterprises would be encompassed in that definition.

- The implications of the above clarification are that financial (and investment income) transactions between two affiliated enterprises that are part of (1) other depository corporations (other than the central bank); (2) other financial intermediaries, except insurance corporations and pension funds; or (3) financial auxiliaries would be excluded from FDI except for transactions in the form of equity capital or permanent debt.

- Financial transactions between units that are not financial intermediaries and affiliated financial SPEs abroad should be recorded under FDI."

The statement promulgating this decision emphasized that the effect of the last recommendation is that there is no longer be any difference between the treatment of SPEs that have the sole purpose of financial intermediation and the treatment of SPEs that have the primary purpose of financial intermediation.

II. Concerns/shortcomings of the current treatment

6. The argument has been made that there is little economic difference between permanent debt, which the present methodology specifies should be included in the direct investment data, and other types of debt and liabilities related to usual banking and financial

intermediation activities, which are to be excluded from the direct investment data, in that ultimately, the funds are all fungible. [1]

7. Concerns have been expressed about the difficulty of implementing the recommended treatment, with the result that many countries do not include permanent debt in their data on other capital.

8. The vagueness of the definition of permanent debt has also raised concerns, not least because it can lead to asymmetries in the bilateral data. To address this issue, the 2003 SIMSDI questionnaire asked respondent countries to provide the definition of permanent debt that they use in their direct investment data, with the aim of determining the extent to which there is consensus about what countries view as being permanent debt.

9. The IMF's *Annotated Outline for the Revision of the Balance of Payments Manual, Fifth Edition (AO)* stated that the definition of permanent debt and the possible exclusion of all debt between affiliated financial intermediaries will be considered in the revision of *BPM5*, and asked whether permanent debt between affiliated financial intermediaries should be excluded from direct investment, and whether, and how, the definition of permanent debt should be expanded.

III. Possible alternative treatments

10. There are two options:

(a) To retain the existing methodology for the treatment of permanent debt, as clarified in the decision of the Committee promulgated in 2002, and to amend the manuals to provide a more detailed definition of permanent debt.

(b) To amend the present methodology by removing permanent debt between affiliated banks and between affiliated financial intermediaries from the direct investment data and instead classifying it under Portfolio Investment or Other Investment as appropriate.

11. The comments on the questions raised in the *AO*, namely, *(i) Should this exception [to transactions between units in a direct investment relationship] be extended to [permanent] debt? (ii) Alternatively, should "permanent debt" be defined further, and if so, how?*

---

[1] See the paper prepared by the US Bureau of Economic Analysis for the 2002 meeting of the IMF Committee on the Balance of Payments Statistics, *Exploring the Borderline between Direct Investment and Other Types of Investment: The U.S. Treatment.*

(Paragraph 5.27), show support for retaining the present methodology of including in the direct investment data permanent debt between affiliated financial intermediaries.

Total responses	4	
Yes	1	
No	3	

12. The preliminary results of the 2003 Survey on the Implementation of Methodological Standards for Direct Investment (SIMSDI) also tend to support option (a). Those results indicate that the number of countries that include permanent debt in their direct investment data has improved in recent years. Of the 86 countries[2] for which the issue is applicable, 56 (or almost two thirds) now include permanent debt between affiliated banks, and 46 include permanent debt between affiliated financial intermediaries.[3]

13. The 2003 SIMSDI results also support the need for further defining permanent debt and indicate that the precise definition being used varies across countries, with the most common definition being "subordinated loans". Of the 29 countries that had provided this information at the time of writing, 15 defined permanent debt as being "subordinated loans" or "subordinated debt" [4], including 2 countries that had an additional criterion of a maturity of 5 years or more. Five countries used definitions similar to those given in the *BPM5* and *BD3* of "debt involving a permanent or lasting interest" [5], 4 countries used the definition of "perpetual debt or debt with no fixed maturity" [6], 1 country defined permanent debt as being "both subordinated loans and perpetual debt", 3 countries defined permanent debt as being "debt that is part of the equity capital", and the remaining 2 countries defined it as being all "long-term loans between affiliated banks and between affiliated financial intermediaries".

[2] At the time of writing, 22 respondent countries had indicated that they did not compile data on the other capital component of direct investment, and the 2003 SIMSDI questionnaire responses for 5 OECD countries and 3 non-OECD countries had not been received.

[3] This compares with the results of the 1997 SIMSDI, when half the countries included permanent debt between affiliated banks, and one third of the countries included permanent debt between affiliated financial intermediaries.

[4] Including Australia, Croatia, Estonia, Germany. Hungary, Ireland, Luxembourg, Norway, Portugal, Russia, Slovenia, Spain, and Switzerland.

[5] Including Kazakhstan, Kuwait, Lebanon, and Thailand.

[6] Including Finland, Hong Kong SAR, and the United Kingdom.

IV. Points for discussion

1. Do the DITEG members consider that the existing methodology for the treatment of permanent debt, as clarified in the decision of the Committee promulgated in 2002, should be retained?

2. If so, do the DITEG members consider that the definition of permanent debt should be amended to clarify the meaning of "permanent or lasting interest"?

3. If so, which, if any, of the following definitions do the DITEG members prefer:

(a) "Debt that represents a permanent or lasting interest, in the form of subordinated debt" ***or***

(b) "Debt that represents a permanent or lasting interest, in the form of subordinated debt and perpetual debt" ***or***

(c) Debt that represents a permanent or lasting interest, in the form of subordinated debt and perpetual debt, that also has the purpose of acting as equity"?

4. If the DITEG members do not prefer any of the definitions cited in (3) above, what should the amended definition of permanent debt be?

5. If the answer to 1 above if "No", do DITEG members consider that the present methodology should be amended by removing permanent debt between affiliated banks and between affiliated financial intermediaries from the direct investment data and instead classifying it under Portfolio Investment or Other Investment, as appropriate, in the balance of payments statistics?

References

International Monetary Fund, 1993, *Balance of Payments Manual,* 5th ed. (Washington). Available electronically as a PDF file at http://www.imf.org/external/np/sta/bop/BOPman.pdf

International Monetary Fund, 1995, *Balance of Payments Compilation Guide* (Washington). Available electronically as a PDF file at http://www.imf.org/external/np/sta/bop/BOPcg.pdf

International Monetary Fund, 1996, *Balance of Payments Textbook,*(Washington). Available electronically as a PDF file at http://www.imf.org/external/np/sta/bop/BOPtex.pdf

International Monetary Fund, 2004, *Annotated Outline for the Revision of the Balance of Payments Manual, Fifth Edition* (Washington). Available electronically as a PDF file at http://www.imf.org/external/np/sta/bop/pdf/ao.pdf

International Monetary Fund Committee on Balance of Payments Statistics, 2002, *Exploring the Borderline Between Direct Investment and Other Types of Investment: The U.S. Treatment*, prepared by Ralph Kozlow of the U.S. Bureau of Economic Analysis. (Washington). Available electronically as a PDF file at http://www.imf.org/external/pubs/ft/bop/2002/02-35.pdf

Organisation for Economic Co-operation and Development, 1996, *OECD Benchmark Definition of Foreign Direct Investment,* 3rd ed. (Paris).

IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS AND OECD WORKSHOP ON INTERNATIONAL INVESTMENT STATISTICS

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

ISSUE PAPER #14

PERMANENT DEBT

The views expressed in this paper are those of the authors and do not necessary reflect those of the Bank of Japan

Prepared by the Bank of Japan

November 2004

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)
ISSUE PAPER #14: PERMANENT DEBT

1. Current international standards for the treatment of the direct investment item

The statistical definition of permanent debt is not clearly defined in the IMF *Balance of Payments Manual, fifth edition (BPM5)* or the OECD *Benchmark Definition of Foreign Direct Investment, third edition (BD3)*. Current international standards for the treatment of capital transactions associated with permanent debt with financial affiliates under Direct Investment are as follows;

(a) "Intercompany transactions between affiliated banks and affiliated financial intermediaries recorded under direct investment capital transactions are limited to those transactions associated with permanent debt (loan capital representing a permanent interest) and equity investment or, in the case of branches, fixed assets. Deposits and other claims and liabilities related to usual banking transactions of depository institutions and claims and liabilities of other financial intermediaries are classified, as, appropriate, under portfolio investment or other investment" (*BPM5*, paragraph 372).

(b) The *BD3* says that inter-company flows between affiliated entities involved in these activities be excluded from direct investments (*BD3*, paragraph 40), and that direct investment for banks be restricted to transactions in share capital of its subsidiaries and in permanent debt (defined as representing a permanent interest in the subsidiaries), or in the case of branches, invested in fixed assets (*BD3*, paragraph 61).

2. Concerns of the current treatment

The paragraph 372 of the *BPM5* and paragraph 61 of the *BD3* only defines permanent debt as "loan capital representing a permanent interest", and there are no detailed criteria to be regarded as permanent debt. Thus, the definition and classifications of permanent debt differs across countries. That is, some countries record capital transactions with affiliated banks or affiliated financial intermediaries under Direct Investment, and others classify them under Portfolio Investment or Other Investment. It would result in bilateral asymmetries and international discrepancies where counterpart countries adopt different classifications. Furthermore, under the current treatment of permanent debt, FDI statistics might not adequately reflect the business reality of capital transactions with financial affiliates.

3. Possible alternative treatments

As we proceed with our discussions on permanent debt in the balance of payments, it should be noted that;

(a) most funds (whether from equity capital, retained earnings, or long-/short-term debt capital) that a financial affiliate receives, is used for its banking-business or asset management, except for some of the initial equity capital provided to establish the financial affiliate, and

(b) the *BPM5* says that "for Direct Investment such a distinction (long- and short-term) is not made because it is essentially determined by arbitrary enterprise decisions and because of the fact that there is no meaningful analytic distinction between the two maturities for intercompany flows" (*BPM5*, paragraph 339).

In line with above features, a possible alternative treatment is;
To drop the description of treatment of permanent debt in the upcoming manual. Thus any debt transactions with financial affiliates would be classified into Portfolio Investment or Other Investment as usual banking business, regardless of the percentage of ownership or the original maturity.

4. Points for discussion

1. Do DITEG members consider that it is appropriate to elaborate on the statistical definition of "permanent debt"?

2. Do DITEG members consider that it is appropriate to continue to include capital transactions associated with permanent debt with financial affiliates under Direct Investment?

3. Do DITEG members consider that it is appropriate to include reverse investment (collection of funds from financial affiliates abroad to direct investors) of permanent debt[*] *under Direct Investment?*

5. Supplementary information

According to the "*Foreign Direct Investment Statistics: How Countries Measure FDI 2001*", of the 33 (outward) and 37 (inward) of 61 countries/regions surveyed record transactions between affiliated banks in their FDI statistics, and of the 32 (outward) and 38 (inward) of 61 countries/regions do transactions between affiliated financial intermediaries under Direct Investment.

[*] As for Japan's case, there is a significant volume in cross-border capital transactions associated with permanent debt (permanent loans or perpetual bonds) to enhance a bank's BIS ratio. Such transactions include "collection of funds from financial affiliates abroad to direct investors (reverse investment)" as well as "capital injections to financial affiliates abroad from direct investors".

6. Annex of the most relevant documents

OECD [2003], *Clarification of Foreign Direct Investment (FDI) Concepts: "Permanent Debt"*, DAFFE/MC/STAT(2003)18
Bank of Japan [2003], *Capital Transactions Associated with Permanent Debt with Financial Affiliates Under Direct Investment*, BOPCOM-03/46A

IMF Committee on Balance of Payments Statistics and
OECD Workshop on International Investment Statistics

DIRECT INVESTMENT TECHNICAL EXPERT GROUP

Background Paper to Issue #14,
Permanent Debt Between Affiliated Financial Intermediaries

Discussion of Basle Tier 2 Capital

Prepared by Ralph Kozlow
U.S. Bureau of Economic Analysis
March 2005

Background Paper for DITEG Issue #14,
Permanent Debt Between Affiliated Financial Intermediaries

During the discussion of permanent debt at the December 2004 DITEG meeting in Washington, DC, participants requested information on the definition of "tier 2 capital" under the Basle Accord. Some members of the group believed that this definition might provide a practical and appropriate way of identifying permanently invested debt. Others pointed out that the group had not been provided with the definition of tier 2 capital and therefore could not assess its attributes. Also, some concerns were expressed about using a regulatory definition (mainly aimed at measuring financial soundness) in defining direct investment. This paper is intended as a background document, to inform further discussion of this issue at the March 2005 DITEG meeting.

In July 1988, the Basle Committee on Banking Supervision identified the following items for use in calculating a bank's capital base:

Tier 1 (a) Paid-up share capital/common stock
(b) Disclosed reserves
Tier 2 (a) Undisclosed reserves
(b) Asset revaluation reserves
(c) General provisions/general loan-loss reserves
(d) Hybrid (debt/equity) capital instruments
(e) Subordinated debt

Most of the items on the above list pertain to reserves or owners' equity and therefore do not enter into DITEG's discussion of permanent debt investment. However, tier 2 items (d) and (e) in the list may involve debt positions between parent banks and their foreign affiliate banks and therefore are relevant to the discussion of permanent debt. The definitions of items (d) and (e) from the July 1988 document are as follows (reproduced with italics and boldface type from the original document):

"….**(d) Hybrid (debt/equity) capital instruments**. This heading includes a range of instruments which combine characteristics of equity capital and of debt. Their precise specifications differ from country to country, but they should meet the following requirements:

- they are *unsecured, subordinated* and *fully paid-up*;
- they are *not redeemable* at the initiative of the holder or without the prior consent of the supervisory authority;
- they are *available to participate in losses* without the bank being obliged to cease trading (unlike conventional subordinated debt);
- although the capital instrument may carry an obligation to pay interest that cannot permanently be reduced or waived (unlike dividends on ordinary shareholders' equity), *it should allow service obligations to be deferred* (as with cumulative preference shares) where the profitability of the bank would not support payment.

Cumulative preference shares, having these characteristics, would be eligible for inclusion in this category. In addition, the following are examples of instruments that may be eligible for inclusion: long-term preferred shares in Canada, titres participatifs and titres subordonnés à durée indéterminée in France, Genusscheine in Germany, perpetual subordinated debt and preference shares in the United Kingdom and mandatory convertible debt instruments in the United States. Debt capital instruments which do not meet these criteria may be eligible for inclusion in item (e).

(e) Subordinated term debt: includes conventional unsecured subordinated debt capital instruments with a minimum original fixed term to maturity of over five years and limited life redeemable preference shares. During the last five years to maturity, a cumulative discount (or amortization) factor of 20% per year will be applied to reflect the diminishing value of these instruments as a continuing source of strength. Unlike instruments included in item (d), these instruments are not normally available to participate in the losses of a bank which continues trading. For this reason these instruments will be limited to a maximum of 50% of tier 1."

Selected BOP Recording Issues

For the following reasons, the definition of tier 2 capital may not be appropriate for use as the BOP definition of permanent capital between affiliated financial intermediaries:

1. The inclusion/exclusion of a particular debt position in the tier 2 capital calculation is at the discretion of regulators in individual host countries. This suggests that outward direct investment positions could not be calculated until after regulators in individual host countries determined what intercompany debt positions to regard as tier 2 capital.
2. The above definitions apply to regulatory reports filed by banks. BOP compilers require a definition that is broadly applicable to all types of financial intermediaries. (Note.--To a limited extent, the definitions could be applied to nonbanks; for example, unsecured and subordinated debt could be regarded as a parallel concept. However, because not all unsecured and subordinated debt is accepted as tier 2 capital by bank regulators, the Basle tier 2 concept could not be uniformly applied to other types of financial intermediaries.)
3. Category (e), subordinated term debt, may include debt that is not "permanent," as this term is commonly used, because it includes debt that comes due in less than one year.
4. The amount that can be treated as tier 2 capital in category (e), subordinated debt, is subject to several requirements, including a 20% erosion per year during the 5 years immediately before maturity of this debt. This will generate offsetting BOP direct investment and portfolio or other investment flows, as the debt is steadily reclassified from direct investment to other investment. The 20% erosion factor appears to be arbitrary and, from a conceptual perspective, it is hard to see a rationale for using this factor in calculating direct investment flows and positions.

a. The Basle methodology would result in pulling apart a given financial instrument (such as a note or a bond) held by direct investor, and classifying part of it in direct investment and classifying the remaining part in portfolio or other investment, and re-estimating the parts that are recorded as direct investment and portfolio or other investment annually.

5. The Basle document has been updated or amended several times in recent years. International account compilers generally desire a consistent time series of data, and therefore may prefer not to tie their treatments to a regulatory standard that may be periodically revised.
6. The concept behind the recommended treatment in the BOP standards is that debt that represents a permanent interest should be recorded in direct investment. As noted, tier 2 capital consists of unsecured and subordinated debt. In the event of bankruptcy or liquidation, holders of debt that is unsecured and subordinated are paid after other claimants have been paid. This does not imply that unsecured and subordinated debt represents a permanent or lasting interest.

Conclusions

The issues listed above explain why the Basle Accord definition of tier 2 capital is not well suited to existing BOP concepts of permanent debt. I recommend that DITEG members consider eliminating the distinction between permanent and non-permanent debt from the international standards and classifying all debt between affiliated financial intermediaries in portfolio or other investment. Making this simplification in the accounts would result in more consistent treatment across countries and less burden and confusion for reporters and compilers.

Appendix:

Current international standards

For reference, current international standards pertaining to the measurement of direct investment debt are as follows:

(a) "Intercompany transactions between affiliated banks and affiliated financial intermediaries recorded under direct investment capital transactions are limited to those transactions associated with permanent debt (loan capital representing a permanent interest) and equity investment or, in the case of branches, fixed assets. Deposits and other claims and liabilities related to usual banking transactions of depository institutions and claims and liabilities of other financial intermediaries are classified, as, appropriate, under portfolio investment or other investment." (*BPM5*, paragraph 372)

(b) "OECD recommends that direct investment for banks be restricted to transactions in share capital of its subsidiaries and in permanent debt (defined as representing a permanent interest in the subsidiaries), or in the case of branches, invested in fixed assets.[8]" (*BMD*, paragraph 61)

Footnote 8 of the *BMD* says: "BIS 'second-tier' capital might be a useful indication for compilers regarding what constitutes permanent debt."

(c) "Special purpose entities (SPEs) are (1) generally organized or established in economies other than those in which the parent companies are resident and (2) engage primarily in international transactions but in few or no local operations. SPEs meeting the criteria presented in paragraphs 514-518 are included, with one exception, as direct investment enterprises. Excepted are SPEs with the sole purpose of serving as financial intermediaries; for these, investments recorded under *direct investment* are limited to equity capital and permanent debt." (*Balance of Payments Textbook*, paragraph 542)

"A New Zealand company wishes to borrow funds on the U.S. capital market by issuing bonds valued at $3 million. Under U.S. regulations, only resident companies are allowed to issue such securities on the U.S. market. So the New Zealand company establishes "a $2 subsidiary" in Delaware (a U.S. state) and the subsidiary issues the bonds and lends the proceeds to its parent. As this SPE acts purely as a financial intermediary, only equity capital and any permanent debt provided by the direct investor are classified as *direct investment*…." (*Balance of Payments Textbook*, paragraph 544)