BOPCOM-05/62

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

Banking

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

---

[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?

Disclaimer:

The views expressed in this paper are those of the author and should not be attributed to the International Monetary Fund, its Executive Board, or its management.

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

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

ISSUES PAPER (DITEG) # 21

VARIOUS SPECIAL CASES - BANKING ACTIVITIES

Prepared by
National Bank of Belgium

November 2004

ISSUE NOTE #21 - VARIOUS SPECIAL CASES - BANKING ACTIVITIES

Prepared by the Balance of Payments Unit

National Bank of Belgium, November 2004

1. CURRENT INTERNATIONAL GUIDELINES FOR THE STATISTICAL TREATMENT OF THE ISSUE

- The Balance of Payments Manual, 5th edition (BPM5) states in its paragraph 37, that transactions between affiliated banks can only be considered as direct investment transactions when they are related to equity capital and permanent debt.

  Transactions of another nature must be classified in the appropriate functional component of the balance of payments regrouping the instruments concerned.

  The transactions between banks and affiliated non-financial enterprises are qualified as direct investment transactions in application of the general rules defined in chapter XVIII of BPM5.

  The OECD Benchmark states the same rule in paragraph 61 and precises in its paragraphs 39 and 40 that, exception made of flows between affiliated banks, inter-company flows should be "encompassed within the scope of foreign direct investment transactions" and that "...inter-company flows between affiliated entities involved in these activities (also banking activities) be excluded from direct investment".

- There was an agreement given in 2001 by the IMF BOPCOM and the OECD WIIS to broaden the coverage of the original rule that excludes transactions, other than equity capital and permanent debt, between affiliated banks and between financial intermediaries from the FDI transactions. As a result, the transactions of this kind between entities of the 3 following sub sectors of the financial corporation sector as defined by the SNA93[1] :
  - S122 other depository corporations;
  - S123 other financial intermediaries;
  - S124 financial auxiliaries.

  are excluded from FDI transactions

  This provision aimed to clarify the methodology mainly for SPE's principally engaged in financial intermediary transactions.

  Their transactions, as those of banks, would be excluded from FDI transactions only when made with a counterpart of one of the 3 above mentioned sectors.

2. CONCERN/SHORTCOMINGS OF THE CURRENT TREATMENT

- The distinction made in the treatment of transactions other than in equity capital and permanent debt in function of the counterpart - affiliated banks (or as in the annotated

[1] This approach is proposed in paragraph 5.27 of the annotated outline for the revision of the Balance of Payments Manual, 5th edition (April 2004).

manual "affiliated financial intermediaries") or affiliated non-financial enterprises - implies a correct identification of the activity sector of this counterpart.

One may suppose that for both the BOP compiler and the respondent, such an identification would be difficult; for the BOP compiler it would even imply to expand the data collection procedures in order to dispose of the necessary information and thus to increase the burden for the respondent.

- Also the inclusion of pure banking activities (i.e. loans and deposits) within FDI transactions may appear hard to be justified in an economic way.
  First the aim of the banking activities is to bring together in a secured way different counterparties in the market : the borrowers and the lenders. When an affiliated enterprise borrows from the related bank, the latter is funded by the market and is only channelling the funds from the market to the borrower; the result is the same as when the borrower addresses himself directly to the market.

- In general financial transactions between affiliated enterprises exist because they are related; if the relation would not exist, the transaction would not happen. Considering a bank, the financial transactions mostly exist because it is a bank even with affiliated enterprises. One may say there is a higher level of independence between the transaction and the specific relation between the bank and the affiliated enterprises.

- The above mentioned problem, regarding the identification of the counterpart, may be tackled in different ways by several countries resulting in bilateral asymmetries.

3. POSSIBLE ALTERNATIVE TREATMENTS

There are 3 alternatives to considered, all of them modifying the scope of the transactions (and positions) to be included in FDI transactions (and positions).

- The first option is to extend the definition of FDI transactions to all transactions between affiliated banks, so that also loans and deposits between affiliated banks would be included in FDI transactions. This approach gives the priority to the conformity to the general definition of FDI above the economic rational.

  - The advantage is the simplicity of treatment where no distinction has to be made in function of the quality of the counterpart;
  - This approach does not however take into account the specificities of the transactions between banks where liquidity management is essential, and could justify another treatment[2].

- The second option consists into the full exclusion of all transactions other than those related to equity capital and permanent debt between banks and affiliated enterprises, whatever their nature, from the FDI transactions. This approach favours the economic rational of banking transactions. It will reduce the scope of FDI transactions.
  - This option has the same advantage of simplicity as the first one.
  - This approach classes all the transactions between banks and affiliated enterprises as pure banking transactions, where the FDI relationships do not interfere.

---

2 See § 5.27 of the annotated outline for the revision of BPM5 (April 2004).

- The third option is a deviation from the first one and consists in a differentiated treatment regarding the status of the bank within a group of related enterprises.

  Indeed we could distinguish the situation of what can be called as a "captive bank" from the one of a bank that is simply part, as any other affiliated entity, of a group.

  In the case of a "captive bank", the transactions between the other affiliated enterprises and the "captive bank" will be determined by the membership of the same group, thus by the fact FDI relationships exist. The resulting transactions between the "captive bank" and the affiliated enterprises, whatever their nature, could then be regarded as FDI transactions.

  In the second case, the transactions between the bank and the affiliated enterprises, whatever their nature, will not necessarily be the result of the existing FDI relationships and both the bank for its liquidity management and the affiliated enterprises for their financial management will behave as any other non related bank or enterprise. Those transactions could thus be considered as non FDI transactions.

  - This approach introduces an economic dimension in the rational of the treatment of the transactions.
  - The degree of complexity to apply the rule is higher and implies to have some knowledge of the precise status of a bank, member of a group of related enterprises.

4. POINTS FOR DISCUSSION

1. *Do the DITEG members consider that the treatment of transactions of banks with affiliated banks and other non-financial enterprises as presently proposed in the IMF BPM5 and in the OECD Benchmark Definition should be retained?*

2. *Do the DITEG members consider that the transactions of banks need to be treated in another way than these of the other financial intermediaries (sectors S.123 and S.124)?*

3. *If DITEG members consider that the transactions of the banks should be treated differently, which option should they favour :*
   - *all transactions with all affiliated enterprises, whatever their nature, be treated as FDI transactions;*
   - *all transactions with all affiliated enterprises, whatever their nature, be treated as non FDI transactions, exception made of equity capital and permanent debt;*
   - *introduction of the concept of "captive bank" of which all transactions with all affiliated enterprises, whatever their nature, be treated as FDI transactions; the transactions of ordinary related banks be treated as non FDI transactions, exception made of equity capital and permanent debt.*

Reference
- IMF Chapter XVIII Balance of Payments Manual 5th edition 1993
- OECD Benchmark for FDI 3d edition 1996 chapter III, 5 and VI, 1
- System of National Accounts 1993 chapter IV
- Revision of the Balance of Payments Manual, 5th edition - Annotated outline (April 2004)