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For discussion

D.3 Treatment of Collective Investment Institutions: Outcome of the Public Consultation

Prepared by the Direct Investment Task Team (DITT)

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D.3 Treatment of Collective Investment Institutions: Outcome of the Public Consultation[1]

The public consultation generally agreed with providing further clarification regarding the guidelines on direct investment (DI) in or by collective investment institutions (CIIs). This was largely supported by the possibility to modify the definition of DI with regard to CII. Out of the three alternatives proposed in the guidance note, there was an inclination for Alternative 3 'Modify the definition of DI to exclude certain investments to and by CIIs' and within this option, the views were equally split between Alternative 3.2 and 3.3. From a practical perspective, the respondents viewed both options within Alternative 3 challenging to implement due to the difficulty of seeking the relevant information and were concerned that the costs exceeded the benefits.

The Guidance Note is proposed to be considered by the Committee for decision.

1. **The public consultation[2] revealed general agreement for further guidance in the update of the current *Balance of Payments and International Investment Position Manual, sixths edition* (*BPM6*) regarding the guidelines on direct investment (DI) in or by collective investment institutions (CIIs).** The current guidelines were seen as challenging, given that CIIs could exist in different forms with varying characteristics, which make them difficult to be identified. In addition, the motivation of CIIs is based essentially on the return on their investments without necessarily participating in the management of the invested entities, which resembles portfolio investment more than DI. It was also recognized that the current European practice departs from the *BPM6* guidance, which may imply that clarification is needed for a comprehensive view in the update of *BPM6*. Guidance would be helpful to reduce asymmetries among countries and improve the comparability within CDIS and CPIS as well.

2. **There is large support to modify the definition of DI with regard to CII.** Respondents felt that even with more than 10 percent of the voting power (of the investment fund shares) the purpose is the portfolio return and not to exercise a significant degree of influence on the management of the enterprise. The motivation for most of the CIIs, at times due to shorter investment horizons, is different than the motivation of long-term direct investors. Respondents pointed out that CIIs may be established by a unit or by private equity funds; by not being open to the public, in those cases CIIs would seem to be more captive in nature and not match the definition of "*Other financial intermediaries except insurance corporations and pension funds*" (S.123) or "*Financial auxiliaries*" (S.124). It was also pointed out that Eurostat treats a legally established CII with only one investor not as an institutional unit but as an ancillary unit. CIIs are typically mutualization devices open to many investors where management is outsourced to a professional. Conversely, those not favoring a modification noted that without strong evidence that CIIs have large impacts on DI statistics, a change to the current definition of DI may not be warranted. They also pointed to the risk of opening up for additional exceptions (e.g., SPEs).

3. **Respondents viewed different motivations behind investments by and into CIIs.** Regarding investments by CIIs, some respondents find that the motivation may not necessarily be different from other equity investments under a relation of "influence" (10–50 percent equity stake). However, it was

[1] Prepared by Ms. Padma S. Hurree-Gobin (IMF), and Ms. Francesca Spinelli (OECD), both DITT Secretariat.

[2] Twenty-one responses. See detailed results in Annex II.

acknowledged that investments by private equity and real estate funds are quite different in purpose and motivation from those by other categories of funds. As regards investments in CIIs, their motivation is different from the standard purposes of direct investment: these investments mainly involve the acquisition by financial institutions of significant shares in CIIs, presumably for portfolio management purposes.

4. **Out of the three alternatives for the treatment of CIIs, there was strong support for Alternative 3, namely modify the definition of DI to exclude certain investments by and into CIIs.**

a. **Within alternative 3, views were equally weighed between Alternative 3.2 (treat investments into CIIs (even over 10 percent equity) as portfolio, but leave investments by CIIs over 10 percent as DI) and Alternative 3.3 (exclude all investments in and by CIIs from DI with the exception of private equity and real estate investment funds).**

Alternative 3.2, as pointed out by some respondents, is practiced in the EU, where 10 percent or greater equity stakes **in** CIIs are recorded as portfolio investment based on the notion that these are "collective" investments so that even if the group of investors has an equity stake above 10 percent, it is unlikely that any individual investor in the group does. However, 10 percent or greater equity stakes **by** CIIs are treated as direct investment based on the notion that it is the fund managers, rather than the individual fund participants, who should be viewed as the investors. Another argument in favor of A3.2 is that when CIIs own more than 10 percent, they might have (or might choose at some point to have) some influence on the company.

Supporters for **Alternative 3.3** point that it is most methodologically refined in terms of matching with the DI definition of exercising influence or having a lasting interest. Influence is key to DI, and this option aligns with that. Most CIIs have different rationale for investment than long-term long-lasting investment, with the exception of private equity and real estate funds that seem to be closer to DI given their intention to achieve management influence or control.

5. From a practical perspective, challenges varied. It can be difficult for compilers to identify when a domestic investor invests in a non-listed foreign CII private equity fund separate from other types of CIIs. Further identification of whether the unit is a Private Equity Fund or a Private Equity Company is not possible with currently available data. Regarding listed CIIs resident in each country, tracking down the voting level is not easy given that the information may not be available in custodian data. Also, from the assets side, because this phenomenon is not relevant in all countries, securing the relevant information may require changes in the reporting system that do not have a positive benefit-cost trade-off. Both approaches 3.2 and 3.3, according to the consultation, would require changes to the current methodology, but the relative burden of the two options is difficult to estimate at this stage. Considerations that could be taken into account are the current practices followed in countries for which the weight of these funds is important; a better understanding of the motivation of these funds at the time of their investment; and user needs vis-a-vis compilers' constraints. On balance, respondents preferred the alternative that poses the fewest practical implementation challenges in most countries, when favoring international comparability. There was support for a period of research and testing on Alternatives 3.2 and 3.3 to evaluate the practical implementation challenges of each option before reaching a conclusion of which should be included in the *BPM6* update.

Annex I. WGIIS Consultation on GN D.3

As part of the BPM6 *and* BD4[3] *update process, the OECD Working Group on International Investment Statistics (WGIIS) Secretariat, consulted with WGIIS delegates*[4] *on the DITT GN D.3 to gauge their support and preferences. The OECD also organized a webinar*[5] *on February 4 to discuss the outcomes of the consultation and gather additional insights on the feasibility of the proposed approaches.*

1. **There was strong support (23 respondents) for including further/clearer guidance in *BPM7* regarding DI in and by CIIs in DI statistics.** It was proposed to clearly distinguish investments in and investments by CIIs in the updated guidance but also to provide a more complete and detailed definition that would support the treatment and identification of selected hybrid cases, which cannot be considered as pure investment funds. Respondents mentioned several challenges in the identification of CIIs, for example when using an ITRS system. Many acknowledged difficulties in providing clear guidelines to ensure accurate reporting and a lack of reporting obligations due to the particular independent legal status of CIIs. There was a call for clearer definitions of what we understand by CIIs (including hybrid types such as venture capital). There were also several practical considerations motivating a separate identification of private equity funds from other types of CIIs. Those respondents that currently identify those entities cited some external sources that could help in the identification, while one respondent suggested including a flowchart to help reporters decide which investment should or should not be reported.

2. **There was also strong support (21 respondents) for modifying the definition of DI in order to exclude certain investments to and by CIIs.** Alternatives A3.2 and A3.3 proposed in the GN were the most preferred alternatives, with slightly more preferences expressed for alternative A3.2 (14 respondents selected A3.2, and, 11 respondents selected A3.3).

3. **Alternative A3.3 was generally considered analytically superior,** but concerns were expressed about its feasibility given the difficulties in identifying private equity and real estate funds from other types of CIIs. Many respondents would welcome a clear definition of private equity funds and real estate funds in the guidelines. It was also suggested that clearer reference to the operating entity concept could be included in the definition under A3.3 (instead of Annex 3 in the GN). Some expressed feasibility concerns about the non-operating unit concept requested under A3.3, which requires the identification of the operating nature of non–resident entities in general and, when looking at investment in non-resident private equity or real estate funds, to look-through investment made by the fund before considering it as DI.

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[3] The IMF and the OECD are collaborating in the work of the Direct Investment Task Team (DITT), serving as co-Chairs and in the DITT Secretariat. The OECD's *Benchmark Definition of Foreign Direct Investment, fourth edition* (*BD4*), which is being updated, provides detailed guidance on the compilation of direct investment (DI) statistics in line with the IMF's *Balance of Payments and International Investment Position Manual, sixth edition* (*BPM6*). The WGIIS reviews the guidance notes produced by the DITT and provides feedback at different stages.

[4] Twenty-six countries responded to an online survey set up by the OECD, but not all countries responded to all questions. Includes answers provided by two countries during the earlier WGIIS/BPTT consultation exercise conducted in December 2020.

[5] There were more than 100 participants, and no dissenting opinions emerged during the discussion.

4. **Alternative A3.2, although less analytically sound, was thought more feasible compared to A3.3,** although many countries would still face some difficulties in properly identifying CIIs under this alternative in absence of further guidelines and clearer definitions. While Alternative A3.2 was considered easier to implement and better for cross-country comparability, some felt that it could lead to the misclassification of investment in and by certain types of CIIs from DI to PI.

Table 1. Answers by WGIIS Delegates' to the Questions in the Online Survey

	Yes	No/Partially
Q1. Do you currently record DI in and by Collective Investment Institutions (CIIs) in your inward and outward FDI statistics? DI in CIIs	5	16
DI by CIIs	10	11
Q2. Do you agree that further/clearer guidance is needed in *BPM7* regarding the guidelines on DI in or by CIIs?	23	3
Q3. Do you have difficulties to identify CIIs, in particular private equity funds, from auxiliary and other financial intermediaries?	13	10
Q4. Do you agree that the definition of DI should be modified, as the motivation for at least some 10% or greater equity investments in or by CIIs is different from the description of the functional category of DI in *BPM6*?	21	3

	A1	A2	A3.1	A3.2	A3.3
Q5. The guidance note presents and describes three alternatives for the treatment of CIIs, and three options out of Alternative 3. Do you have a preference for one of the three alternatives and, if choosing Alternative 3, please indicate which option you support[6]?	2	2	1	14	11

[6] Some respondents selected more than one alternative.

Annex II. Summary Results of the Public Consultation

1. Do you agree that further/clearer guidance is needed in the update of the current Balance of Payments and International Investment Position manual regarding the guidelines on Direct investment in or by collective investment institutions (CIIs)?

Yes	No
81%	19%

2. Do you concur that the definition of DI should be modified given that the motivation for at least some 10 percent or greater equity investments in or by CIIs is so different from the description of the functional category of DI in the *BPM6*?

Yes	No	Abstention
62%	19%	19%

3. The GN presents and describes three alternatives for the treatment of CIIs, and three options out of Alternative 3. Do you have a preference for one of the three alternatives and, if choosing Alternative 3, please indicate which option you support?

Alternative 1	Alternative 2	Alternative 3				Abstention
14%	0%	67%				19%
		Alternative 3.1	Alternative 3.2	Alternative 3.1	Abstention	
		7%	43%	43%	7%	