Workshop on International Investment Statistics

Draft OECD Benchmark Definition of Foreign Direct Investment, 4th edition

PRELIMINARY PROPOSALS FOR THE TREATMENT OF PASS-THROUGH FUNDS AND CAPITAL IN TRANSIT IN FDI STATISTICS

by the OECD Benchmark Advisory Group

Proposals included in this document should be considered as work in progress but not as final recommendations.

OECD Workshop on International Investment Statistics is invited to review revised proposals at its next meeting to be held in March 2007.

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Box 1. Pass-through funds and capital in transit: the Background

**DITEG recommendation (March 2005)**

(v) DITEG did not reach a consensus and was not in a position to determine the methodology in response to the request of the OECD Investment Committee to include in the *Benchmark Definition* recommendations to isolate “genuine FDI further broken down by partner country and by industry classification.” As the balance of payments does not address specifically bilateral data issues, DITEG recommended deferring the discussion to Benchmark Advisory Group of the OECD Workshop on International Investment Statistics.

**WIIS deliberation (April 2005)**

(4) WIIS agreed that the *Benchmark Definition* would include recommendations (a) to provide detailed statistics (by country and industry classification) according to the principles retained for core BOP/IIP accounts; (b) to provide detailed statistics (by country and industry classification) as an of which category: FDI excluding SPEs (based on national definitions).1 The *Benchmark Definition* will once again include an Annex on SPE which will be improved in the most useful way to include criteria to identify SPEs and to provide guidance to national compilers. Even though this approach was not considered to be the final solution to this issue, it will provide an interim response to the request by the OECD Investment Committee. WIIS also endorsed continuation of the work on SPEs as a part of the future research agenda.

(5) Even though all WIIS participants did not agree that there is a loss of information, WIIS agreed that developmental work be co-ordinated with the work on UIC/UHC principles for a supplemental presentation.

**WIIS deliberation (April 2006)**

In response to pressing user needs, WIIS created the project group on SPEs to develop a methodology for the treatment of “capital in transit” and “pass-through funds” in FDI statistics. WIIS requested that this work to be closely co-ordinated with the work of the project group on Ultimate investing/host country.

**Developmental work to date:**

An initial version of a proposal, prepared by the Netherlands and France, was presented to WIIS as a room document for information. Following the creation of the PG on SPEs this proposal was further developed by incorporating complementary views. The proposal benefited from the input of PG members. The Netherlands took the lead in preparing the present document and incorporating in the proposal the contributions of the PG. It should be noted that the proposal is still “work in progress” and should by no means be considered as a firm proposal.

The document is circulated as a proposal by the PG-SPEs for consideration by WIIS in October 2006.

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1. This recommendation was not supported by the statistical bodies of the European Commission: Eurostat and European Central Bank.
1. **Introduction**

1. Following the request of the WIIS in its April 2006 meeting, the project group (PG) on SPEs has prepared an overview of SPE issues and other closely related issues that could be discussed during the October 2006 meeting. In the present paper, the PG has taken into account the documents and presentations that were already available in April 2006 as a starting point. As views have changed since then and the understanding of several issues has improved, the paper also offers new angles from which one could look at the problems at stake.

2. A so-called combined approach is proposed in this paper to improve the interpretability of the FDI core accounts. Obviously, it cannot but have a rather general character at this stage, not only because of time constraints but also because of the desirability of further guidance by the WIIS, possibly also on the basis of the outcome of an investigation by the ECB into user needs. As a result, the proposal in this document has a preliminary character in that it offers a “dotted line” between the starting point and the end, a line from user needs to FDI statistics. It also points at alternative avenues that could be chosen, other goals that could be aimed at, varying between more modest ones to more ambitious ones. Thus, the PG has tried, by providing a detailed description of issues it has discussed in the past few months, to guide the WIIS along a possible route while showing alternatives along the way. The present document has been structured accordingly.

3. A short look backward is given in Section 2, taking stock of the main problems and building blocks already available for a solution, and describes how the thinking of the group has evolved. The PG investigated different options, both from a conceptual and a practical point of view. Section 3 provides an outline of a solution of the main problems based on elements put forward by the participants of the PG. The so-called combined approach tries to deal with capital in transit problems via “empty shells” and inflation problems in general, by distinguishing

   - SPEs and other entities
   - reporting entities ultimately controlled by resident and non-resident UIPs
   - different foreign counterparties

4. One of the main principles underlying the combined approach is that the user of FDI statistics should be provided with sufficiently detailed gross figures in order to calculate for himself the subtotals or net amounts in which he is most interested. Section 3 therefore discusses the possibility of a definition of SPEs as well as different breakdowns by counterparties, allowing for different ways to extend the

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2. At the time of writing, the results of questionnaires sent to users were not yet available.

3. In line with existing terminology and abbreviations for *countries* in different manuals and the literature – UI for the ultimate investing country and UH for the ultimate host country – the words UIP and UH indicate the corresponding *entities*, i.e. the ultimate investing Parent and its ultimate Affiliate in the host country.

4. See also Annex 1.
directional principle. Whether the combined approach can also be applied to country groups, is investigated in Section 4. The PG has also touched upon the issue of SPEs in relation to the ultimate origin and ultimate destination problem, the “U/U” problem, also called the UIC/UHC problem. Section 5 may be considered as a bridge between the activities of the PGs on SPEs and UIC/UHC. Section 6 provides preliminary conclusions.

2. The starting point in retrospect

5. When discussing the draft of the new BMD, in April 2006, the WIIS was confronted with still many question marks in the text reflecting unsolved issues regarding capital in transit and U/U problems. After some presentations and a discussion of the state of affairs it was concluded that a solution, even if all possible cases cannot be resolved, should be incorporated in BMD4 to reduce the problems users are increasingly confronted with when using the so-called FDI core accounts. Some members of the WIIS were invited to participate in a project group on SPEs and to further investigate the problems, using among other things the (ECB) documents that had already been discussed during an ECB Workshop on FDI statistics in March 2006.

2.1 Problems

6. The documents submitted to the WIIS in April 2006 highlighted once more the need for “genuine” FDI figures in the analysis of economic growth, productivity and employment, along with the need for gross, unadjusted figures in the analysis of financial markets or the role of specific countries as financial hubs. Unfortunately, users of FDI statistics interested in the relationship between “genuine” FDI and economic growth, the origin of capital in developing countries or the spreading of technology via FDI, for instance, are still confronted with problems that increasingly hamper their analysis. The diversity of these problems is illustrated in Diagram 1. Some of the main (sometimes overlapping) problems are

1. an increasing lack of insight in genuine, non inflated FDI;
2. the increased blurring of the borderline between FDI and other capital and, related to this;
3. the growing divergence between capital that is controlled and invested by a country;
4. increasing difficulties in constructing aggregates for country groups;
5. an increasing lack of insight in the ultimate origin and destination of FDI capital.
Diagram 1 is complicated, as is every day reality, but a walkthrough may help to classify the main causes of, for instance, the inflation of FDI financial flows and positions. In some countries it is mainly caused by SPEs (see Diagram 1, flows 9 to 11). In most other countries ever growing flows of capital between “normal” members of groups of enterprises also account for a deterioration of this inflation problem. Examples are the flows 1, 2 and 3 for the group controlled by B and flows 12 and 13 for the group controlled by A. Treasury centres, ancillary units controlled by A or B (drawn separately here for explanatory purposes), also account for part of the inflation problem (see Diagram 1, flows 4 to 7).

The inflation of flows and positions can be partly reduced by the directional principle that is still applied in current statistics. Flow 3 could be a reversal loan, and would – without the directional principle – contribute to an inflation of the data according to users that are more interested in net amounts. The directional principle does not cover, however, flow 3 if it comes from an entity that is not directly owned or influenced by the ultimate investing parent A (the UIP).

The diagram has been included to have an encompassing, common reference point for discussions in the rest of this document. It pertains to flows, going in only one direction (to keep things “simple”), but can be supposed to apply to stocks in the same way.

The treasury centres TRC1 and TRC2 in the diagram might have a non-negligible number of employees. They are supposed to perform financing intermediation for their respective groups only (as ancillary units), thus producing services in the form of better financing conditions, stability in times of financial strains etc.
The inflation problem

9. In most countries inflation seems to be caused in the lower half of Diagram 1 (flows 4 to 11), by all kind of entities that serve as international turning tables or in house banks for liquidity management etc. Although the discussion often focuses on “SPE problems”, and the very name of the project group, on SPEs, might give the impression that these problems should be attributed to SPEs, the problem is actually even broader and not restricted to SPE countries. In “normal” countries resident affiliates of resident UICs too may account for a substantial inflation of FDI data. They may perform the same activities as SPEs, including sub-holding, the providing of day to day financing to other foreign members of the same group, the pooling of excess liquidities and so on.

10. Via so called brass plate entities ultimately controlled by a foreign entity, without any production or staff and performing no financial intermediation (transformation of maturity, interest rates, repackaging), FDI capital may be passed from one country to another, thus inflating the FDI statistics of the country where the empty shell is established (flows 10 and 11).

11. Whereas these sub-holding activities and the pass-through of intra-company loans inflate the outflow and inflow of FDI capital by equal amounts, leaving net FDI unaffected, in other cases net FDI flows (and positions) too may be distorted. Empty conduits, for instance, use to issue securities and on-lend the proceeds to the mother (or other members) of the group to which they belong (flows 8 and 9). In this case the inflation concerns only one leg.

12. Contrary to the previous example, this kind of on-lending would not only affect the statistics of the country of the conduit, but also those of its counterparts, where an inflow of FDI capital is recorded that actually represents an attraction of portfolio capital. In Diagram 1, flow 1 coming from SPE3 shows a similar distortion. In both cases the issuance of securities blurs the borderline between FDI and other capital.

13. The inflation of FDI figures is often attributed to the above mentioned, foreign owned “empty shells”, which have little or no employment. As indicated, however, similar operations with similar inflating and distorting effects may be performed by (resident) foreign affiliates that do have a non negligible number of employees and act as treasury centres. These could even be involved in some local production (see Diagram 1, flows 7 and 8).

14. In addition, all kinds of mixed forms exist, varying across countries and – to complicate things further – over time as well. This is probably the main, well known reason why it has been so difficult so far to agree on a definition of the entities whose transactions or stocks should be excluded from FDI statistics or presented as ”of which” items.

Other problems

15. Other problems concern the construction of aggregated data for country groups, such as the European Union and the euro area. The problem here is that an SPE that one might identify as such at the national level, does not necessarily have to be an SPE at the EU level. Capital flowing into an SPE in an EU country from outside the EU could leave this country and go partly to other EU countries, partly to the rest of the world.

16. Finally, another conceptual problem concerns the breakdown of total FDI figures by industry, as it is not self-evident how one should deal with a pass-through of capital (via an SPE or “regular” entity) from, for instance, the telecom member of a group in one country to the construction member in another country (see Diagram 1, flows 12 and 13 could be an example).
2.2 Building blocks for a solution

17. During the April 2006 meeting of the WIIS, time was too limited to go into any discussion of details. In view of the big number of issues and alternatives that could be considered, the PG has confined its work to the more promising elements that could be used in solving the problems described above (they will be discussed in more detail further on).

2.2.1 The identification of capital in transit.

18. The identification of entities responsible for the capital in transit, empty shells in particular, is a major building block for a solution of most of the interpretation problems with current FDI statistics. Identifying entities seems to be preferable over the identification of individual transactions, which would be too costly. Although a definition of SPEs had not yet been agreed about in April 2006, even confining it to certain types of empty shells or singling out SPEs on the basis of national definitions would already be a major step forward.

2.2.2 The so-called netting approach.

19. The netting approach is another building block, based on the assumption that users may want to know which amount of FDI is controlled or influenced, on balance, by foreign direct investors in a given country, and which amount this country itself controls or influences, on balance, abroad. This approach therefore proposes to provide users gross data that are sufficiently broken down of the calculation of net non-inflated figures he may be interested in. This requires data that are reported by

(a) entities controlled by resident UIPs on the one hand and

(b) entities controlled by non-resident UIPs on the other.

Net amounts calculated for the first group are called outward, to indicate the direction of control; likewise, net amounts for the latter are called inward.

20. The original idea was to apply the netting procedure to each individual reporting entity, thus extending the directional principle, which limits the netting to the first link up or down an investment chain (although deviations from this rule can be observed in practice).

21. The version proposed in April 2006 to the WIIS limited the netting to foreign counterparties controlled by the same UIP, i.e. entities belonging to the same group, in order to deal with at least the inflation caused by daily flows of capital within groups. That version went less far, but still implied an extension of the directional principle, because it no longer restricted the netting of positions to entities that are directly related to each other. It embodied a greater emphasis on control, as had already been suggested by the ECB Workshop in March 2006. The possibility of limiting the netting to directly controlled or directly controlling foreign entities only was not considered, however, as this would have gone in the opposite direction by narrowing rather than broadening the current coverage of the directional principle, which also covers relationships of direct influence.

2.2.3 A dual presentation of a geographical breakdowns of FDI data

22. Geographical breakdowns could be made both by direct counterparty countries (DCPs) and by ultimate investor or ultimate host countries (UICs/UHCs). It was suggested that, in order to get a full picture of worldwide FDI controlled by UIPs in a specific country (the UIC), this country should show not only the amounts its UIPs have invested abroad themselves, but also the positions these UIPs control in an
indirect way, via SPEs, for instance. Likewise, compilers in UHCs could add to a breakdown by DCPs a breakdown by UICs.

2.2.4 A method to calculate the influence exerted by a UIP in other countries

23. The influence a UIP exerts abroad by its own direct investments, can be estimated, for instance, by means of a multiplication method, resulting in so-called adjusted equity positions in the entities abroad that it controls or influences. Such a method was proposed by the BEA of the US. Geographical breakdowns based on this method would allow users to better look down a chain or tree of control or influence.

2.2.5 Ideas regarding country groups

24. In order to get more meaningful data for country groups as well, it had already been proposed in April 2006 to distinguish between EU-residents and non-EU-residents, for instance, in the same way as at the national level. However, no proposal had been made yet on how to deal with empty shells at country group levels.

25. During the April 2006 meeting, members of the WIIS asked questions on several of the above mentioned building blocks, for instance if the netting approach did not imply the risk of netting too much, thus creating a deflation problem. The WIIS concluded that this point, along with other problems, should be further investigated by the project group. It was also recommended to see if elements of the main solutions that had been presented, particularly the capital in transit (or SPE) approach and the netting approach, could be merged (Diagram 2). The PG on SPEs has therefore taken the possibility of a combined approach as its starting point.

DIAGRAM 2 – The struggle for a combined approach

3. A combined approach

26. As has already been indicated above, neither the netting approach nor the SPE or “capital in transit” approach solves all problems. This will be shown in this section for the inflation problem. A combined approach seems therefore necessary and will be proposed as a tentative solution. Its implications and complications – the need for extra information, a definition of SPEs and the problem of border cases
when it comes to distinguishing control from influence – are discussed next. Other problems will be further dealt with in Sections 4 (the aggregation problem) and Section 5 (SPEs and the U/U problem).

3.1 The need to combine “solutions”

27. As has already been noted, singling out SPEs, as best as one can, and leaving it at that, would not address the problem of the daily inflation of flows between “normal” entities, including resident “treasuries” of resident UIPs. The contribution of the latter to the inflation of FDI data can be very serious, as has been shown for France (35 per cent of total stocks) and Canada (25 per cent). Also, singling out SPEs would not solve the problem that an incoming loan (flow 1 in Diagram 1), taken up by a resident UIC with a foreign affiliate, possibly an SPE, might actually consist of the proceeds of an issuance of securities on the international capital markets. Incidentally, this borderline problem is not solved by the netting approach either.

28. While the netting approach does cover intra-company flows and positions, including those of resident treasuries, thus limiting the inflation of FDI figures they cause in “normal countries”, there remain other problems that can not be solved by this approach either. In SPE countries in particular, the netting approach could lead to large deflation problems, even though allowing for the calculation of deflated figures is its very objective. In the Netherlands, the netting approach would lead to too much deflation. On the inward side the overshooting would be over €200 billion.

29. The main problem here is that assets and liabilities may be inflated by different amounts and therefore need different corrections, whereas netting implies, by definition, equal corrections. This holds for the assets and liabilities reported by entities ultimately controlled by resident UIPs, outward FDI, as well as for those controlled by non-resident UIPs, making up inward FDI. On the inward side, for instance, the deflation problem may occur if money flows in as portfolio capital but flows out, via an SPE, as FDI capital.

30. In the diagram below, the net inflow of genuine FDI on the inward side would be 1 \(-/\) 6. However, the netting approach would result in a net inflow of 1 \(-/\) 6 \(-/\) 3. This overshooting problem cannot simply be overcome by suggesting the user of FDI statistics to look not only at the net figure, but also at total gross data. After all, this would still not allow him to extract from total assets (3+6) the non relevant item (3) he would like to ignore.

**Diagram 3 – The netting approach and the deflation issue**

\[
\begin{align*}
\text{UIP} & \quad 1 \\
\rightarrow & \quad \text{SPE} \\
\downarrow & \quad 2 \\
\rightarrow & \quad \text{UIP} \\
\downarrow & \quad 3 \\
\rightarrow & \quad \text{X} \\
\downarrow & \quad 4 \\
\rightarrow & \quad \text{PF}
\end{align*}
\]
31. This kind of netting problem would not arise, of course, if SPEs reported equal amounts of FDI abroad and in the reporting country (i.e. if flow 2, in Diagram 3 represented a flow of FDI instead of portfolio capital and were equal to flow 3); the netting would then eliminate their impact on gross assets and liabilities on the inward side of FDI. In practice, however transformation activities of SPEs may be quite substantial, which is the reason why countries such as Luxemburg and the Netherlands use to include “of which” items for SPEs in their national publications of FDI or publish tables including and excluding SPEs.

32. Another example may show that the netting approach can be appropriate, provided it is applied with care. In its original form, presented in April 2006, the netting approach still suffered from another type of undesirable deflation in outward FDI, caused by corrections having nothing to do with SPEs, such as the correction of flow 4 in Diagram 3 (the subtraction of flow 5). Flow 4 could be a genuine net outflow, reported by a resident UIP, whereas flow 5 might be the minority stake taken in it by a foreign entity (itself the UIP of a different group). This stake could even be as big as to make the net outward position negative. Hence, netting the amounts 4 and 5 would imply a loss of meaningful information.

33. This kind of deflation problem, which could also arise on the inward side, can easily be solved, however, by excluding any minority interest from the netting procedure. It can be dealt with, at least conceptually, by limiting the netting approach to relationships between entities that belong to the same group.

3.2 Towards a more comprehensive solution

34. From the examples above it will be clear that neither the SPE approach or “capital in transit” approach, nor the netting approach provides a solution to all problems, although both go already a long way in meeting user demands. However, the first approach still deflates too little, because it does not solve the “treasury problem” and leaves normal daily two way traffic unaffected, whereas the second one deflates too much because it does not solve the empty conduit part of the SPE problem (the part caused by the transformation of portfolio capital into FDI).

35. The PG has made an effort to merge both approaches into one combined approach that not only better suits SPE countries, by preventing large deflation problems, but also improves the FDI figures of other countries, by better solving their “treasury problem”. The combined approach is based on specific assumptions on the information users of FDI statistics may want to see:

(1) genuine flows and stocks;
   (a) genuine, inward flows and stocks, controlled by non-resident UIPs, indicating the attractiveness of a country to foreign direct investors;
   (b) genuine, outward flows and stocks, controlled by resident UIPs, indicating, for instance, the participation of a country in the process of globalisation,

(2) net figures, in addition to gross figures on stocks and every day intracompany operations, that may to a large extent offset each other,

(3) gross figures and a breakdown of them, showing the contribution of pass through capital to total figures owing to a country’s role as a financial centre, the attractiveness of its tax climate etc.
36. Consequently, the following features seem analytically relevant

1. the distinction between resident UIPs and non-resident UIPs,

2. the distinction between control (majority interest – more than 50 per cent) and influence (between 10 to 50 per cent),

3. the distinction between SPEs and other entities.

37. These elements have been incorporated in the three tentative tables for FDI data below, in which the combined approach has been worked out for an individual country. It has been assumed that it will indeed be possible to make the distinctions 1 to 3 and define SPEs sooner or later (see below). Several levels of ambition are possible here, depending on what is supposed to be feasible in practice and depending, in particular, on how far one would like to extend the scope of the directional principle, which is how large one makes the group of foreign counterparties on which one would like to have additional information to calculate net amounts. Therefore several options are presented below, reflecting different breakdowns by control and influence. Table 1 shows the options, Table 2 how they could be worked out.

**TABLE 1 – Ways to extend the scope of the directional principle**

<table>
<thead>
<tr>
<th>Directional principle</th>
<th>Table 2A</th>
<th>Table 2B</th>
<th>Table 2C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct control</td>
<td>Group member</td>
<td>direct control</td>
<td>Group member</td>
</tr>
<tr>
<td>Adjusted versions of the DP</td>
<td>direct influence</td>
<td>direct control</td>
<td>(in)direct control</td>
</tr>
<tr>
<td>Table 2A</td>
<td>Group member</td>
<td>direct control</td>
<td>Group member</td>
</tr>
<tr>
<td>Table 2B</td>
<td>Group member</td>
<td>direct control</td>
<td>Group member</td>
</tr>
<tr>
<td>Table 2C</td>
<td>Group member</td>
<td>(in)direct control</td>
<td>Group member</td>
</tr>
<tr>
<td>Note: Circles represent reporting entities.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

38. Table 2A would be the most ambitious option. It requires entities to distinguish between positions *vis-à-vis* counterparties belonging to the same group and *vis-à-vis* other counterparties (feasibility will be discussed below). Table 2B has been included to illustrate that limiting the netting to counterparties controlled by (or controlling) the reporting entity *itself*, comparatively easy as it may look, would actually mean a step back backward relative to the present situation. Table 2C, which extends the directional principle to *indirectly* controlled entities and preserves relationships of direct influence could be an intermediate step in a step-by-step approach.
TABLE 2 – FDI positions *vis-à-vis* direct counterparts*

2(A). Split between intra-company counterparties and other counterparties

<table>
<thead>
<tr>
<th>Reporting entities</th>
<th>Total</th>
<th>SPEs</th>
<th>Other 1)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INWARD</strong>&lt;br&gt;(Data reported by resident entities controled by non-resident UIPs)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign direct counterparty</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Intracompany</strong>&lt;br&gt;2)</td>
<td>Liabilities</td>
<td>Assets</td>
<td>Net liabilities</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Other</strong>&lt;br&gt;3)</td>
<td>Liabilities</td>
<td>Assets</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Reporting entities</th>
<th>Total</th>
<th>SPEs</th>
<th>Other 1)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OUTWARD</strong>&lt;br&gt;(Data reported by (resident entities controled by) resident UIPs)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign direct counterparty</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Intracompany</strong>&lt;br&gt;2)</td>
<td>Assets</td>
<td>Liabilities</td>
<td>Net assets</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Other</strong>&lt;br&gt;3)</td>
<td>Assets</td>
<td>Liabilities</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1) "Genuine"
2) Relationships with the UIP or foreign entities ultimately controled by the same UIP as the reporting entity
3) Relationships with foreign entities not belonging to the same group as the reporting entity

2(B). Split between directly controlled or controlling entities and other counterparties

<table>
<thead>
<tr>
<th>Reporting entities</th>
<th>Total</th>
<th>SPEs</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INWARD</strong>&lt;br&gt;(Data reported by entities controled by non-resident UIPs)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Controled/controling counterp.1)</td>
<td>Liabilities</td>
<td>Assets</td>
<td>Net liabilities</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Other counterparties</strong></td>
<td>Liabilities</td>
<td>Assets</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Reporting entities</th>
<th>Total</th>
<th>SPEs</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OUTWARD</strong>&lt;br&gt;(Data reported by entities controled by resident UIPs)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Controled counterp.1)</td>
<td>Assets</td>
<td>Liabilities</td>
<td>Net assets</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Other counterparties</strong></td>
<td>Assets</td>
<td>Liabilities</td>
<td></td>
</tr>
</tbody>
</table>

1) The control is supposed to be direct and to be exerted by or upon the reporting entity itself

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6. In the tables the compiler could already have calculated some net amounts himself, but this could also be left to the user.
2(C). Split between directly influenced/influencing and (in)directly controlled/controlling entities and other counterparties

<table>
<thead>
<tr>
<th>INWARD</th>
<th>OUTWARD</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Data reported by entities controlled by non-resident UIPs)</td>
<td>(Data reported by entities controlled by resident UIPs)</td>
</tr>
<tr>
<td><strong>Control / Direct influence 1)</strong></td>
<td><strong>Control / Direct influence 1)</strong></td>
</tr>
<tr>
<td>Liabilities</td>
<td>Assets</td>
</tr>
<tr>
<td>Assets</td>
<td>Liabilities</td>
</tr>
<tr>
<td>Net liabilities</td>
<td>Net assets</td>
</tr>
<tr>
<td><strong>Other counterparties 2)</strong></td>
<td><strong>Other counterparties 2)</strong></td>
</tr>
<tr>
<td>Liabilities</td>
<td>Assets</td>
</tr>
<tr>
<td>Assets</td>
<td>Liabilities</td>
</tr>
</tbody>
</table>

1) Counterparties are members of the same group. The (in)direct control or direct influence is exerted by (or upon) the reporting entity itself.
2) Direct influence, counterparty does not belong to the same group as the reporting entity.

39. The tables above may be used for different purposes by different users, depending on their interests. It is left to the user to look at gross or net data, the column SPE or Other (i.e. genuine) or to ignore figures or whole columns altogether. In any case, the tables continue to include all data that are already available in current FDI statistics. Advancing on Section 5, it may be noted here that the outward side of the table for a given country could even be further enriched by adding a column with total amounts of indirect FDI, i.e. the amounts of FDI controlled abroad but not directly invested by (UIPs in) the country itself.

3.3 Practical implications and complications

40. A major practical question is of course if enterprises would be able to provide the additional information needed to fill the tables above, and what that would mean for their administrative burden. The following information would have to be reported for the combined approach:

3.3.1 Is the UIP of the reporting entity a resident?

41. Each entity would have to report to its national compiler if its UIP is a resident or not. Most entities will probably be able to give the answer, in an annual questionnaire, for instance, but in some cases compilers may have to use additional data from international business registers or private institutes such as Dunn & Bradstreet. If an entity would not be able to answer the UIP-question, an option could be to just classify its liabilities on the inward side and its assets on the outward side.

7. The breakdown by counterparties in this table reflects a so-called DIIC focus on FDI [on relationships of direct influence and (in)direct control].

8. To get less inflated data it suffices to know if the UBO is a non-resident; the country of the UBO does not matter, although it does, of course, for geographical breakdowns, and therefore needs to be asked for as well (see Section 5).
3.3.2 What is the relationship with the foreign counterparty?

42. Whether a counterparty belongs to the same group as the reporting entity may sometimes be difficult to ascertain for a reporting entity. The objective of getting this information is rather ambitious, even though most entities may know if they are doing business with an entity belonging to the same group or not. A less ambitious approach would be to start by a presentation as in Table 2C and change over to Table 2A later on. However, some difficulties may still remain. An entity might have to report on transactions with foreign entities on which it exerts an indirect control through cumulative ownership chains (Diagram 4). The examples of “joint control” given here are not exceptional. They could therefore need to be brought under the definition of control, in line with the way of reasoning underlying the Framework for Direct Investment Relationships.

43. Finally, whatever additional information would have to be reported, what matters is how much more it would cost entities to distinguish, for instance, intra-company positions and other positions, given that the corresponding Table 2C implies an extension of the directional principle – by indirectly controlled or controlling entities – they are already used to.

3.3.3 Is the reporting entity an SPE?

44. In the present situation, individual countries still use their own SPE definitions for national publication purposes, but a commonly agreed definition would seem useful as well. The PG has therefore studied the possibility of a not too ambitious definition of SPEs, to be widened in the future, that at least covers the empty shells whose main activity is sub-holding (SPE1 in Diagram 1). This activity is classified in ISIC/NACE classes 6420 and 6430. This definition of SPEs would include, as a minimum, (foreign owned) direct investment enterprises that have little or no employment and no revenue from the sale of services, i.e. sub-holdings that are generally referred to as empty shells or brass plates.

45. In some countries this definition might cover already most of the SPEs. In other countries it might not, however, as it does not yet take into account the empty conduits (SPE2 in Diagram 1). For those entities a specific ISIC/NACE class to extend the definition of SPEs does not (yet) exist. The question is, however, if it really is a problem if these entities would be considered as “normal” enterprises. It should be noted that empty conduits, whose main activity is to on-lend portfolio capital or bank loans, may have

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9. Activities of holding companies (6420) and of “Trusts, estates and agency accounts, administered on behalf of the beneficiaries under the terms of a trust agreement” (part of the definition of 6430). See also Annex 1.
relatively high foreign FDI assets. On the inward side these assets would strike the eye anyway (in Table 1 the assets of empty conduits would now show up in the column “Other” instead of the column “SPE”).

46. A drawback of not treating empty conduits as SPEs could be that their assets would be mixed with those of other non-SPE affiliates. Whether this mixing is acceptable would depend on the relative weights of empty conduits and other entities on the inward side, an issue still to be investigated, and on the need of users to analyse them separately.

47. In any case, it may be concluded that even a “narrow” definition of SPEs would already be a step forward, even though better solutions remain needed that go further than the empty shells, and also cover pass-through entities like SPE2, TRC1 and TRC2, whose operations continue to inflate the FDI data.

48. If a definition of SPEs could not be agreed upon, even a breakdown of total FDI in “Genuine FDI” and “FDI reported by SPEs” on the basis of current national definitions would already be a major improvement. For the time being, each country could (continue to) use the definition that it considers most appropriate to deal with the country specific SPE problems it is familiar with. Incidentally, the use of national definitions would not imply a loss of bilateral symmetry in total gross figures, as they all continue to be shown in Table 1 and remain available for checking purposes.

49. Breakdowns on the basis of national definitions are likely to differ across countries, but the ensuing lack of comparability might be overcome by footnotes that give background information to the users. In the end, users might be happier with figures they understand and can interpret, thanks to footnotes, than with comparable, but distorted figures that meet conditions of bilateral symmetry in which most of the time average users may not be interested.

4. Extending the combined approach to country groups

50. The foregoing pertained to individual countries. An important question for international compilers is if the combined approach could also be applied to country groups such as the European Union. In this section this is verified for the three main features of the combined approach.

4.1 Distinction between resident and non-resident UICs

51. For the compilation of EU aggregates it does not suffice that if an entity reports to its national compiler its UIC is a non-resident. It also has to report if the UIC is a non-resident outside the euro area. Entities in long chains or complicated trees may not always know this. Compilers in different countries may need to consult each other or rely on Dunn & Bradstreet, the European Business Register etc. If the residency of the UIC remains unknown, positions can not be classified as inward or outward. In supplementary tables for country groups they could be presented separately. It should be noted that they can still be netted, as a reporting entity only needs to know – and could be supposed to know – if its FDI relationship with a non-resident entity is an intra-group relationship or not.

4.2 Classification of counterparties into “netting candidates” and other counterparties

52. To a reporting entity, on being asked if it directly or indirectly controls a counterparty or directly influences it, it may not make much difference where the counterparty is established. It is probably able to provide this information for both purposes (tables for individual countries or country groups) or it is not able to do so at all. If the information is available, it can be used for the compilation of (European) aggregates as well. The same holds for the question if a counterparty is a member of the same group.
4.3 Is the reporting entity an SPE?

53. At first sight, this question might not appear as a real issue at highly aggregated country group of levels. After all, the larger a group of countries the smaller the odds to find pure SPEs that pass through all the capital they receive from a country outside the country group to another country outside the group. It would seem more normal that a European entity engaged in the pass-through of capital serves as a turning table for direct investment outside the EU as well as in the EU itself (Diagram 5). Such an entity would therefore be most likely a “normal” enterprise, not an SPE. In this way, one could simply define away the SPE problem at the EU level.

54. Yet it is obvious that empty shells are different than other entities. The PG has not yet formulated a view on the question if to large groups of countries one can or should apply the same definition of an SPE – if it were available – as for an individual country. Empty shells do inflate the FDI data by large amounts. In Europe, for instance, they include the combined amount of all the capital the US channels via individual European (SPE) countries to Asia. The mere reason that there is more capital to “dilute” (flow 4 in Diagram 5), it may not be a sufficient reason to neglect this type of inflation altogether.

55. From Diagram 5 it will be clear that the opposite view, that the entity is an empty shell and should therefore be kept out of FDI statistics or not even be reported about at all by national compilers, is not appropriate either. In that case, the European compiler would miss a probably large part of genuine FDI in the EU itself (included in flow 1) and genuine FDI by the EU abroad (included in flow 3).

DIAGRAM 5 – Do European SPEs exist?

56. Irrespective of the possibility of a definition of an SPE and its applicability to the European level, it is very unlikely that users would not be interested in the large amounts passed through the EU, so the PG has paid attention to this problem too. The main point to be kept in mind, in this respect, is that the incoming amount of FDI in Diagram 5 can not be allocated across flows 3 and 4 in a self-evident way, not

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10. At the national level, in SPE countries, this problem is also encountered, but the amounts invested in these countries via SPEs are small relative to “genuine” FDI reported by non-SPEs and even smaller relative to the sometimes huge amounts passed through.
even in this simple example. It goes without saying that things get even more complicated for networks consisting of many entities or for longer intra-European chains of entities.

57. A second best option could be to show in FDI tables for the EU as a whole not only the extra-EU positions of empty shells (in the SPE column) but also their positions vis-à-vis other residents of the EU (Table 3). The user may consult this information to get a rough idea of the amounts that could be channelled via the empty shells to and from EU countries and non-EU-countries. In the table below, this type of information has been added. It could be left to the reader to make best guesses himself to get an idea of the pass-through phenomenon, i.e. the part of extra-EU assets (8) that has been financed by extra-EU and intra-EU liabilities. This would be a difficult task but yet it could give at least some indications.

**TABLE 3 – FDI figures for the EU, a possible breakdown**

<table>
<thead>
<tr>
<th></th>
<th>INWARD</th>
<th>OUTWARD</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Data reported by entities controled by non-resident UIPs)</td>
<td>(Data reported by entities controled by resident UIPs)</td>
</tr>
<tr>
<td>Control/direct influence 1)</td>
<td>Total</td>
<td>SPEs</td>
</tr>
<tr>
<td>Liabilities</td>
<td>18</td>
<td>12</td>
</tr>
<tr>
<td>Assets</td>
<td>18</td>
<td>8</td>
</tr>
<tr>
<td>Net liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other counterparties</td>
<td>Liabilities</td>
<td></td>
</tr>
<tr>
<td>Assets</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

5. Global asymmetries in the combined approach and the U/U problem

58. One of the features of the combined approach is that is does not necessarily imply global equality of assets and liabilities that can be called genuine FDI. A country may report an increase in liabilities as genuine FDI which is not fully reported and matched anywhere else in the world as an increase in assets that can also be called genuine FDI. This could occur, for instance, if an SPE in Belgium attracts portfolio capital and directly invests it in Poland for its parent company in France (Diagram 6). In this final section, it will be shown that the work in the PG on UIC/UHC is relevant to the PG on SPEs as well, as a solution to the ultimate origin and ultimate destination problem, the \textit{U/U problem}, for short, also implies a solution to the global asymmetry issue raised here. This will be discussed first. Next a new approach will be presented that allows users to see how the influence exerted by the direct investment of a UIP (itself) can be allocated across different countries further down the chain.
5.1 The UHC/UIC problem

59. In Section 3 it was already announced that the FDI tables shown there could be further enriched by extending the outward side by an additional column for assets and liabilities of entities that are not direct counterparties but are indirectly controlled. If a reporting entity is the UIP of a chain, it could use this column to report on the total amounts it directly or indirectly controls worldwide. This additional information (including the 30 in Diagram 6 that is missing in accounts broken down by UHCs) would reduce the inequality of global assets and liabilities representing genuine FDI. More complicated cases have also been studied by the PG and can be treated in a similar way.

60. Given that it is only a small step from this proposal – adding a column – to the proposal to use the same column also for a geographical breakdown by UHCs, some attention is also paid here to the conceptual aspects of the U/U problem, as had also been done already in the documents presented to the WIIS in April 2006. The main idea (still) is to calculate net assets for all directly and indirectly controlled entities in different host countries down the chain (see Diagram 7, in which entity X is the only entity that does not belong to the group controlled by P). For the UHAs (ultimate affiliates) in Ultimate Host Countries along the way down, the picture does not need to be completed, as by definition no amounts are missing (nothing has to be rerouted to them, as everything goes the parent). However, their statistics for different counterparties (DCPs) could be complemented by a geographical breakdown by Ultimate Investor Countries. This breakdown too could be very helpful to the users, as it usually differs substantially from a breakdown of transactions or positions by DCPs.
61. The additional column on the outward side in Table 4A could meet the needs of users who would like to look through SPEs and analyse data on the total global direct investment position of a country, including stakes in foreign enterprises that have been financed by entities down the chain. On the inward side of FDI, in Diagram 7 reported by D, all liabilities would now be attributed to UIC A, allowing users to also look upward the chain. Table 4B gives an example for an intermediate country (B in Diagram 7) of the reshuffling that is needed to get a geographical breakdown that could make more sense on the inward side of SPE countries as well.

**TABLE 4 – A dual breakdown by direct counterpart countries (DCPs) and UHCs/UICs**

A. Breakdown by UHCs on the outward side

<table>
<thead>
<tr>
<th>OUTWARD FDI reported by country P</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Data reported by entities controlled by resident UIPs)</td>
</tr>
<tr>
<td><strong>By DCP</strong></td>
</tr>
<tr>
<td><strong>Control/direct influence</strong></td>
</tr>
<tr>
<td>Assets</td>
</tr>
<tr>
<td>Liabilities</td>
</tr>
<tr>
<td>Net assets</td>
</tr>
<tr>
<td><strong>Other counterparties</strong></td>
</tr>
<tr>
<td>Assets</td>
</tr>
<tr>
<td>Liabilities</td>
</tr>
</tbody>
</table>
B. Breakdown by UICs on the inward side (assuming the reporting entity in country B is an SPE)

<table>
<thead>
<tr>
<th>INWARD FDI reported by country B</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Data reported by entities controled by non-resident UIPs)</td>
</tr>
<tr>
<td>By DCP</td>
</tr>
<tr>
<td>SPEs</td>
</tr>
<tr>
<td>Control/direct influence</td>
</tr>
<tr>
<td>Liabilities</td>
</tr>
<tr>
<td>Assets</td>
</tr>
<tr>
<td>Net liabilities</td>
</tr>
<tr>
<td>Other counterparties</td>
</tr>
<tr>
<td>Liabilities</td>
</tr>
<tr>
<td>Assets</td>
</tr>
</tbody>
</table>

62. Thinking about geographical breakdowns at the European level one again runs into the problem that SPEs at this level are not easy to define. However, the columns in Table 3 ("FDI figures for the EU, a possible breakdown"), including outward and inward positions plus positions of empty shells vis-à-vis residents, could in principle all be broken down by both DCP and UIC if the information is available. The interpretation of the result could of course remain as difficult as for total figures.

5.2 The allocation-of-influence problem

63. The U/U problem can also be interpreted from a totally different perspective by asking how much influence country P exerts down the chain, i.e. all over the world, by investing 100 in country A. In April 2006, a new approach, developed by the BEA of the US for equity positions, was presented to the WIIS to reallocate amounts such as the abovementioned 100 across controlled and directly influenced entities (Diagram 8). At each link of a chain, the immediate influence is indicated by the ratio of incoming equity to total assets. Multiplication of immediate influences gives an indicator for the effective influence the UIP is supposed to have at a given link: in A the immediate influence is 100/200, in B it is 70/400, making the effective influence in B equal to 100/200 * 70/400 = 8.75%. The effective influence percentage is supposed to equal the share of the UIP in the outgoing investment: given the influence of the UIP in B, of 8.75%, it is supposed to end up with a stake of 8.75% of 100 in D, that is 8.75. This amount is subtracted from the amount that B would have got, if B itself had been at the end of the chain (35). So B gets 26.25. Likewise, the net amounts that B, X and D end up with, are subtracted from the amount that A could have kept, if A had been the end of the chain (100; correction makes it 0).

64. One of the main differences between this approach and the previous one is that the BEA approach (intentionally) does not show flows that start anew in affiliates somewhere down the chain. The goal is to determine the ultimate destination of the financing supplied by the direct investor. This explains why the results may be difficult to interpret when compared to the “regular” FDI data based on direct counterparts (an example is the zero position of P in A in the BEA approach as compared to the direct investment of 100 in A).

11. In order to facilitate a comparison, the figures in Diagram 7 have been copied from Diagram 8 (which contains the original figures used in the example of the BEA).

12. In the document presented to the WIIS by the BEA this percentage is called the Parents-equity share of affiliated assets (PESAA).
6. Conclusion

On the basis of the analysis above, merging different building blocks in a so-called combined approach looks promising, for individual countries to begin with:

(i) SPEs could be defined as empty shells with sub-holding activities, so that a link can be established to the SNA and ISIC/NACE classifications. The fall back option would be to single out SPEs on the basis of national definitions. In any case, the singling out of empty shells, as major contributors to capital in transit, seems imperative.

(ii) Reporting entities could be distinguished by resident and non-resident controlling UIPs.

(iii) A first step, in a step-by-step approach, could be to apply the combined approach to annual positions only.

(iv) Gross data could be reported about in more detail, so that users can decide themselves which subtotals or net amounts they would like to calculate. Gross positions that users may want to analyse separately could, for instance, concern the following foreign counterparties:

   (a) Entities belonging to the same group as a reporting entity, or

   (b) Entities (in)directly controlled by or (in)directly controlling the reporting entities, or

   (c) Controlled or controlling entities (b) plus directly influenced or influencing group members

(v) A similar breakdown could possibly be made for country groups too, the foreign entities then having to be defined as non-residents with respect to the country group. The SPE problem could be defined away, as pure European SPEs, for instance, are likely to be rare. Yet, users may not want compilers to neglect large pass-through amounts channelled via European empty shells between different continents. Data on positions of empty shells vis-à-vis other residents (in other countries) in the country group could in some cases be helpful as supplementary information.
(vi) Problems at the level of country groups, economic unions, etc. have not yet been resolved. However, this need not prevent WIIS from conducting further work on the improvement of individual country data.

(vii) As regards the different geographical breakdowns discussed above, they could be further studied in the coming months, also in relation to the SPE problem and the aggregation problem. They may help solve the U/U problem and the allocation-of-influence problem and imply new ways of looking down the chain that could be interesting for the users of FDI statistics.
ANNEX 1. DEFINING SPEs

Box 2. Definition of SPEs

The following text, circulated on 14 September 2006, was not discussed or commented by the SPE Project Group due to lack of time. It is included in the present document for preliminary general comments by WIIS and for the consideration of specific questions included in the document.

********************
Summary

(i) This document proposes a SPE definition that is based on or linked to the ISIC/NACE classes 6420 and 6430. It basically concerns entities not performing any activities that are often referred to as brass plates or empty shells.

(ii) It is proposed to earmark SPEs that are fulfilling the definition and to link them via the business registers with the SNA institutional sectors.

(iii) The identification of SPEs on the basis of a common definition in the financial accounts/BoP, enables compiling internationally comparable FDI data with an ‘of which’ category pertaining to SPEs. The common definition would additionally allow for these data to be aggregated in a meaningful way, for instance, to the EU level.

(iv) In view of the limited data that can in practice be collected from SPEs, it could be considered to confine their reporting requirements in line with a more concise presentation of their FDI relations. This possibility is not further elaborated in this document but could be further addressed by the PG Income and the PG SPEs.

13. Document provided by Eurostat includes preliminary elements.
1. Introduction

66. The PG SPEs does not only address the distortions in FDI data of countries with large populations of SPEs, but also capital in transit going through other countries. This contribution is restricted to the first issue and aims at defining SPEs. It additionally addresses the possibility for the counterparties of SPEs to identify the latter.

67. As regards SPEs, the WIIS and the IMF BOPCOM earlier decided that the inflation of FDI data at the national level can be addressed in the core accounts (i.e. BoP/IIP) by introducing an ‘of which SPE’ item in FDI statistics. Although Eurostat agrees that this would improve the data presentation/interpretation at the national level, Eurostat and the ECB are currently not in favour because data with differing national definitions cannot be aggregated to the EU/euro area level. Thus, an internationally agreed upon definition of SPEs would be helpful in solving this issue, allowing lifting those reservations. It may also be useful in the framework of the broader discussions in the PG SPEs, in which the need for a SPE-definition is sometimes also felt.

2. Proposal for an SPE definition

68. More in particular, this contribution is an effort to define part of the entities generally referred to as SPEs within the framework of ISIC/NACE and, indirectly, to the institutional sectors of the SNA/BoP. In view of the numerous types of activities presently attributed to SPEs in the BoP context, it appears impossible to reach a definition that would comprise all of them. In my view it should be accepted that any SPE definition, firmly based in the activity classification, can consist of only a part of the entities that may be referred to as SPEs at the national level.

69. The proposal is to define SPEs as entities that have little or no employment and no revenue from the sale of services, are direct investment enterprises (foreign owned). They are thus entities whose principal activity is necessarily included in ISIC/NACE class 6420 and 6430. In practice it would pertain to entities generally referred to as empty shells or brass plates, notably those that are foreign owned, and have no subsidiaries/affiliates in the country of residence.\(^{14}\)

70. In the revised ISIC/NACE, two classes have been created that consist of entities in principle fulfilling the definition, but only one of them (6420) appears to be fully in accordance with the objectives of the SPE definition (see paragraph 3.1). Class 6430, should be broken down so that only part of the entities would be considered SPEs (see paragraph 3.2). To allow linking ISIC/NACE with the SNA institutional sectors, steps have been taken to bring the SNA definition of Holding corporations in line with ISIC/NACE 6420 (see paragraph 4). Although some of the discussions are still ongoing, it appears that the proposed SPV (or SPV\(^{15}\)) definition could get a firm basis in the new classifications by institutional sector and by activity (industry).

\(^{14}\) Those are relevant for the BOP point of view. If entities fulfilling the proposed SPE definition are subsidiaries/affiliates of entities of the same country of residence they might be considered as ancillary units to the latter units (thus not recognized as institutional units on their own).

\(^{15}\) The wording “SPVs” is also used to indicate special purpose entities/vehicles which lack a specific definition. If the above definition were agreed upon, it could be considered as a definition for SPVs, while SPVs could be seen as a specific sub group of the wider range of (largely undefined) SPEs.
3. ISIC/NACE

3.1 Activities of holding companies

71. In the new activity classifications ISIC4/NACE2, classes 6420 (Activities of holding companies) and 6430 (Trusts, funds and similar financial entities) are both included under section K "Financial and Insurance Activities". They are special in the sense that they consist of entities not actually performing any activities in the traditional sense, i.e. without involving a production function with employment, fixed assets and inputs. The Explanatory notes of ISIC/NACE, describe class 6420 as follows.

642 – 6420: Activities of holding companies

72. This class includes the activities of holding companies, i.e. units that hold the assets (owning controlling-levels of equity) of a group of subsidiary corporations and whose principal activity is ownership of the group. The holding companies in this class do not provide any other service to the businesses in which the equity is held, i.e. they do not administer or manage other units.

73. This class excludes:

- active management of companies and enterprises, strategic planning and decision making of the company, see 7010.

74. It is proposed to include all entities that fulfil the description of 6420 (and are foreign-owned) in the group of SPEs as defined in paragraph 2 above. The structure of the classification (text in bold) and the Explanatory notes, as shown above, are identical in the new ISIC4 and NACE2 classifications. For NACE Rev. 2, the structure is final, given the progressed state of adopting the EU NACE/2 Regulation. ISIC4 has already been adopted by the UN Statistical Committee in March 2006. However, the Explanatory notes of both ISIC and NACE are still in the drafting phase and are therefore open for further discussion.

Q-1 Do the members of the PG SPEs agree that entities whose principal activity is in class 6420 should be included in SPEs?

Q-2 Do the PG members have any suggestions for adjusting the above Explanatory notes to class 6420?

75. According to ISIC/NACE draft Explanatory notes above holding companies are units that hold the assets “(owning controlling-levels)” of equity of a group of subsidiary corporations. The (present) SNA also speaks of “controlling” when defining holding corporations. Since FDI also includes minority shares (of more than 10%) the following questions arise.

Q-3 Where should entities be classified that fulfil the ISIC/NACE definition of holding companies, with the exception that they hold minority shares (of at least 10%)?

Q-4 Do the members of the PG SPEs find it likely that SPE/holding companies would hold minority shares? Would the exclusion of these entities from an eventual SPE-definition largely affect data?
3.2 Trusts, funds and similar financial entities

76. The other types of entities that are not performing any activities in the traditional sense, i.e. without involving a production function with employment, fixed assets and inputs are included according to the new ISIC/NACE in class 6430.

643 - 6430 Trusts, funds and similar financial entities

77. This class includes legal entities organized to pool securities or other financial assets, without managing, on behalf of shareholders or beneficiaries. The portfolios are customized to achieve specific investment characteristics, such as diversification, risk, rate of return and price volatility. These entities earn interest, dividends and other property income, but have little or no employment and no revenue from the sale of services.

This class includes:

- open-end investment funds
- closed-end investment funds
- trusts, estates or agency accounts, administered on behalf of the beneficiaries under the terms of a trust agreement, will or agency agreement
- unit investment trust funds

This class excludes:

- funds and trusts that earn revenue from the sale of goods or services, see ISIC class according to their principal activity
- activities of holding companies, see 6420
- pension funding, see 6530
- management of funds, see 6630

78. Of the entities included in this group Trusts, estates or agency accounts, administered on behalf of the beneficiaries under the terms of a trust agreement, will or agency agreement would qualify as SPEs under the proposed definition in paragraph 2. But in quantitative terms, this class may be dominated by the (cross border stocks and flows of) Open/closed-end investment funds and Unit investment trust funds. Traditionally, mutual funds and their managers are separate legal entities, and while the latter are without contest institutional units, the former are considered institutional units by convention (ESA 2.40f). ESA1995 explicitly view mutual funds as financial intermediaries. This is because the main function of those vehicles is to obtain a significant reduction in risk and operating costs obtained by way of pooling investors’ funds, thus implying a genuine ”repackaging of funds”.

79. Thus, in ISIC/NACE, the activities of these entities are split in two classes. Class 6630 Fund management activities includes the financial service provided by the fund managers, who take investing decision and carry out administrative tasks, on behalf of the investors. This activity does not pertain to financial intermediation, but to financial auxiliary activities because the management is generally not at risk. Class 6430, on the other hand, contains the shell of the investment funds, i.e. the legal entity that hosts the assets and associated liabilities. The shell does not perform any activity in the traditional sense, but is
by convention included in financial intermediation. In the SNA/BoP and financial accounts these mutual funds (and especially the financial assets and liabilities of the investors) are shown separately in the subsector Mutual funds (or Investment funds).

80. In view of this, a simple one-by-one classification of all entities in 6430 as SPEs would not be correct. Instead, two alternative approaches could be considered.

- Exclude all entities to which the activities in class 6430 pertain from the definition of SPEs.
- Separate the entities in 6430 in:
  1. Trusts, estates or agency accounts, administered on behalf of the beneficiaries under the terms of a trust agreement;
  2. Open/closed-end investment funds and Unit investment trust funds; and only include the first group (in so far as foreign-owned) in SPEs.

**Q-5 Would the members of the PG SPEs support breaking class 6430 down into SPEs and mutual funds (i.e. open/closed-end funds, unit investment trust funds)?**

If so, it could be proposed to include this breakdown in the Explanatory notes of ISIC/NACE for 6430.

**Q-6 Do the PG members have any additional suggestions for adjusting the Explanatory notes to class 6430 (especially to improve the applicability of the proposed SPE definition)?**

4 SNA and BoP

4.1 SNA reference to holding corporations

81. Differently than in new ISIC/NACE, the present SNA defines holding corporations ‘as corporations that control a group of subsidiary corporations and whose principal activity is owning and directing the group’. In the new ISIC/NACE, on the other hand, ‘overseeing and managing of other units …’ is an activity that is included in 7010 Activities of Head Offices. Clearly, the SNA reference “and whose principal activity …” was principally meant to exclude from the definition the many corporations that have subsidiaries but that have other activities. However, the reference of “owning and directing” is ambiguous, as it could be construed to either aim at characterising ownership functions, or on the contrary also capture management/administrative tasks.

701 – 7010 Activities of head offices

82. This class includes the overseeing and managing of other units of the company or enterprise; undertaking the strategic or organizational planning and decision making role of the company or enterprise; exercising operational control and manage the day-to-day operations of their related units.

This class includes activities of:

- head offices
- centralized administrative offices
- corporate offices
- district and regional offices
- subsidiary management offices.

This class excludes:

- activities of holding companies, not engaged in managing, see 6420.

83. In our view, it is highly recommendable that there is a direct link between ISIC/NACE and the breakdown by institutional sectors in the new SNA. Initiatives have therefore been taken to separate the definition of holding companies and of head offices in the new SNA in the same manner as in ISIC/NACE. Under the assumption that BPM6 will endorse the future SNA institutional (sub) sectors, this opens the road for earmarking and separately presenting SPE’s (i.e. class 6420 in ISIC/NACE) in the BoP, without including head offices (see paragraph 5).

4.2 Head offices

84. Regarding class 7010, Head offices, Eurostat still has a remaining concern with respect to linking ISIC/NACE and the SNA. In ISIC/NACE head offices are included in section M which consists of non-financial activities. If the SNA institutional sectors were to be linked to ISIC/NACE, as proposed in the next paragraph, all head offices that are institutional units would be classified as non-financial corporations (S.11) in the SNA. This would generate economically undesirable results if it concerns head offices managing financial corporations (and not performing any other significant activities). It would for instance imply that in the BOP financial accounts the (FDI) relationships of a head office of bank with its (foreign) affiliates would be classified in the non-financial sector. By the same token, the ESA financial accounts, the equity stakes of S.11 into S.12 would not have plausible interpretation. Eurostat has raised this issue in the ISWGNA.

5. Business registers

85. The new EU Business Register Regulation, which is presently in the process of being adopted, defines the variables that should be included in the Member States business registers. It also defines the information that should be made available at the EU level for multinational enterprise groups and their constituent units at individual unit level. It will include variables for both institutional sector and industry (activity) classification.

86. The Commission/Eurostat could give guidance to the MS’s on how industries and institutional sectors should be linked (still under discussion). If agreement could be reached on a common SPE definition, e.g. pertaining to the entities in ISIC/NACE class 6420 and part of 6430, SPEs could be clearly identified in the business registers on behalf of the BoP. This would open the road for presenting FDI

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16. If, apart from managing, the head office (institutional unit) would be more engaged in performing financial activities for the group (in terms of its value added), the ISIC/NACE classification must be in financial activities. In that case there is no concern for misclassifying head offices of financial corporations in the financial accounts. If information on value added is not available, it is recommended to use proxies like employment: if staff is engaged in financial services activities, the unit should be classified in 649.

17. At this stage it is foreseen that the Regulation should be in effect by 1 January 2007, i.e. MSs’ business registers should be in accordance with the Regulation from that date (but MSs can ask for a derogation). According to present plans, the European multinational groups register would be available to MSs and EFTA (if interested) countries in 2009. Subsequently, access for ECB/NCBs will have to be regulated through comitology.
going through SPEs in a separate ‘of which’ item on the basis of a common definition. This would, in principle, not only have to apply to national data for countries hosting large populations of SPEs. EU/euro area counterparty of SPEs located in the EU/euro area could also identify their counterparties by consulting the business register available at the EU level. Countries outside the EU could consider taking comparable measures.

Q-7 Would the PG SPEs members consider the proposed link in business registers to earmark SPEs on behalf of the BoP desirable and feasible?

Q-8 Do the PG SPEs members have a preference to denominate the entities defined in this proposal as either SPEs, or SPVs (see footnote 2)?
ANNEX 2: OECD BAG – PROJECT GROUP SPEs (EDG)

France
Japan
Luxembourg
Netherlands
United States
ECB
Eurostat

IMF
OECD