

## ***1. General Information***

### ***Name***

Direct investment

### ***Supervisor of statistics***

Central Bank of Iceland, Statistics and IT

### ***Purpose***

The purpose of statistics on direct investment is to measure Iceland's foreign direct investment (FDI) transactions and positions with non-residents. Statistical reporting on direct investment is carried out according to the standards defined by the Organisation for Economic Co-operation and Development (OECD) in the *OECD Benchmark Definition of Foreign Direct Investment - 4th Edition* (BMD4). The BMD4 defines presentation, methodology, valuation, and terminology.

### ***References***

The Central Bank collects data directly from resident entities that are considered to be in a direct investment relationship with non-resident entities. Data from the Directorate of Internal Revenue and the Register of Annual Accounts are used as well. Other data are also considered if they are deemed reliable.

### ***Statutory authority***

The compilation of data, calculation, and publication of the balance of payments is provided for in Chapter VI of the Act on the Central Bank of Iceland, no. 36/2001 and the Foreign Exchange Act, no. 87/1992. These Acts (and the pertinent regulations, including the Rules on the Obligation to Provide Information in respect of Foreign Exchange Transactions and Cross-Border Capital Movements, no. 13/1995) contain provisions on resident entities' disclosure

requirements and on the obligation of Central Bank employees to observe confidentiality concerning the data compiled for statistical reporting.

## ***2. Methodology***

### ***Terminology and definitions***

#### ***Residents and non-residents***

The definition of a resident as set forth in the BMD4 accords with that in the Foreign Exchange Act, no. 87/1992: any individual permanently resident in Iceland in accordance with the provisions of the Act on Legal Domicile, irrespective of nationality. Students and embassy employees are exempt from the residency requirement. Therefore, Icelandic students and their families who reside abroad are considered residents, and foreign embassy employees are considered non-residents. Non-residents shall mean all parties except residents.

**Direct investment** measures direct investment transactions and positions deriving from transactions between resident and non-resident entities in a direct investment relationship.

**Direct investment relationship:** A direct investor, a direct investment enterprise, and fellow enterprises are considered to be engaged in a direct investment relationship.

**Direct investor:** An entity that, through its ownership share, has acquired control or influence over an enterprise with a registered address in another country or economy. A direct investor controls a total of 10% or more of the voting rights in the enterprise concerned.

**Direct investment enterprise:** An enterprise under the control or influence of a direct investor.

**Fellow enterprises:** Entities that are neither under the control or influence of one another but are both under the control or influence of the same direct investor.

The **ultimate controlling parent** is the entity at the top of the chain of ownership, where control over companies is maintained through direct or indirect majority ownership.

**Control:** A company that wields a total of 50% or more of the voting power in another company through direct or indirect ownership is considered to have control over the latter company.

**Influence:** A company that wields a total of 10-50% of the voting power in another company through direct or indirect ownership is considered to exert influence over the latter company.

**Direct ownership:** An ownership share in another company.

**Indirect ownership:** Ownership in a company through another company.

**Direct investment position:** Provide information on the total stock of investment made abroad and received from abroad

**Direct investment flows** net transactions with inward and outward financial assets and liabilities.

**Transactions** related to direct investment are defined as interactions wherein the parties trade financial assets and liabilities by mutual agreement.

**Real estate** transactions are classified under direct investment. Investments in individual properties are considered equity transactions. Real estate transactions can be limited to a single piece of property but can also include real estate companies or holding companies.

Loans between parties in a direct investment relationship are not included with direct investment if both parties are a deposit money bank, an equity fund, or another financial undertaking (apart from insurance companies and pension funds). In such instances, the loans would be classified under other investment.

Shareholdings and other securities holdings between residents and non-residents are classified as portfolio investment (holdings less than 10%) unless there is a direct investment relationship between the parties. Investments in equity securities are usually short-term and, unlike direct investment, are not intended to exert control over the management or policies of the company.

With direct investment, it is assumed that the direct investor's intention is to influence the management and policies of the direct investment enterprise and to establish a long-term business relationship. The loans granted by an investor (the investor's non-equity contribution) are viewed as additional investments in the firm concerned.

Direct investments in assets and liabilities are segregated further based on the relationship between the parties. There are three types of direct investment relationships:

**Investment by direct investors in direct investment enterprises.** The direct investor's position and transactions with equity or loans to his direct investment enterprises (irrespective of whether they are under his direct or indirect control or influence).

**Reverse investment.** This type of relationship covers the direct investment enterprise's position and transactions with equity (under 10%) or loans to the direct investor.

**Investment between fellow enterprises.** This covers the position and transactions between enterprises that have no control or influence over one another but are both under the control or influence of the same direct investor.

**Special purpose entities (SPE)** are included with direct investment according to the asset and liability principle but are excluded in statistics according to the directional principle (see definitions below). SPEs are companies that are often established for tax purposes and whose actual operations are limited or non-existent. Some companies of this type are registered in Iceland; however, they are wholly owned by non-residents and own stakes in or loan claims against FDI related companies abroad, but they have no domestic assets. Actually, they are only shells for capital flowing through Iceland and have very limited economic impact. SPEs are included in statistics on Iceland's balance of payments and international investment position from 2013 onwards, but reliable information on their balance sheets from before that time has been lacking.

### ***The nature of direct investment***

Transactions in direct investment are classified according to whether they belong under equity or loans.

**Equity.** Transactions with equity take the form of share capital and reinvested earnings.

**Equity securities transactions:** Equity securities are claims for a specified ownership share in an undertaking, and they entitle the owner to a portion of the book value of the company and its annual profit.

**Reinvestment:** Reinvested earnings is an imputed value that includes the portion of net profit (excluding price and exchange rate movements) that is not paid out to shareholders as dividends. Reinvestment therefore reflects changes in the value of equity between two periods.

## **Loans.**

**Loans** are financial assets generated when a lender loans money directly to a borrower. Loans are further classified as long- and short-term claims and debts.

**Debt securities** are negotiable instruments serving as evidence of a debt. Among them are bills, bonds, notes, certificates of deposit, debentures, asset-backed securities, money market instruments, and similar instruments normally traded in the financial markets.

**Deposits.** Deposits are standardised, non-negotiable agreements offered by deposit-taking institutions (deposit money banks, or DMBs). The term of deposits can vary, depending on the agreement. Deposits generally imply that the debtor is obliged to return the principal to the investor.

**Trade credit** is a claim generated when a provider of goods or services grants a customer an extension of time to pay or receives advance payment for goods or services. The trade credit and advances derive from the fact that payment for the goods or services is not remitted at the time the goods are delivered or the service provided.

**Other accounts receivable/payable** includes accounts receivable or payable other than those specified above. They can include tax liabilities, securities transactions, wages, or dividends.

## ***The directional principle***

Direct investment is recorded in statistical reports according to the directional principle.

Under the directional principle, direct investment is entered either as *outward direct investment* (if the direct investor or ultimate controlling parent of other fellow enterprises is a resident entity) or as *inward direct investment* (if the direct investor or ultimate controlling parent of other fellow enterprises is a non-resident entity). The direction of the investment is determined by the following formula:

***Outward direct investment:*** *Resident investors' investment in non-resident enterprises – non-resident enterprises' investment in the resident investor (reverse investment) + resident fellow enterprises' investment in non-resident fellow enterprises if the ultimate controlling parent is a resident – non-resident fellow enterprises' investment in resident fellow enterprises if the ultimate controlling parent is a resident.*

***Inward direct investment:*** *Non-resident investors' investment in resident enterprises – resident enterprises' investment in the non-resident investor (reverse investment) + non-resident fellow enterprises' investment in resident fellow enterprises if the ultimate controlling parent is a non-resident – resident fellow enterprises' investment in non-resident fellow enterprises if the ultimate controlling parent is a non-resident.*

### **Totals according to the directional principle:**

*Total direct financial assets according to the directional principle = equity + net loan positions (loan claims – loan obligations)*

*Total direct investment flows according to the directional principle = net equity securities transactions (purchases – sales) + reinvestment + net loan transactions (loan transactions due to loan claims – loan transactions due to loan obligations)*

Increases are indicated with a positive sign (+) and decreases with a negative sign (-).

SPEs are excluded from statistics compiled according to the directional principle.

**Change in presentation in compliance with BMD4:** Until 2013, the direction of investments between fellow enterprises was determined in many cases by the domicile of the entity that

owned a direct holding in the resident entity and not the ultimate controlling parent, as has been done from 2013 onwards, in accordance with the OECD's new BMD4 standards. The change in presentation of loans between fellow enterprises causes a reduction in financial assets in both directions from 2013 onwards because a portion of outward direct investment assets is now deducted from inward direct investment assets. The reclassification has no effect on the net position between residents and non-residents, as it is only a change in presentation.

### ***Asset/liability principle***

In balance of payments statistics and in the IIP, direct investment is presented according to the asset/liability principle, which entails entering asset and liability items on a gross basis (claims between parent companies and their subsidiaries are not netted against one another). For example, under this presentation, a loan owed by resident investor to a non-resident entity owned by that investor is now entered on the liabilities side in the IIP and is not netted out against the investor's claims against the non-resident entity on the assets side. The asset/liability principle follows the formula below:

*Assets: Resident investors' investment in non-resident enterprises + resident enterprises' investment in the non-resident investor (reverse investment) + resident fellow enterprises' investment in non-resident fellow enterprises if the ultimate controlling parent is a resident + resident fellow enterprises' investment in non-resident fellow enterprises if the ultimate controlling parent is a non-resident.*

*Liabilities: Non-resident investors' investment in resident enterprises + non-resident enterprises' investment in the resident investor (reverse investment) + non-resident fellow enterprises' investment in resident fellow enterprises if the ultimate controlling parent is a resident + non-resident fellow enterprises' investment in resident fellow enterprises if the ultimate controlling parent is a non-resident.*

Increases in assets and liabilities are indicated with a positive sign (+) and decreases with a negative sign (-).

SPEs are included with direct investment according to the asset/liability principle and are measured back to 2013. No reliable information is available from before that time.

### ***Relationship between directional principle and asset/liability principle***

It should be noted that direct investment figures in the balance of payments and the IIP are not fully comparable with direct investment statistics presented according to the directional principle.

The net position according to the directional principle excluding SPEs is equal to the net position according to the asset/liability principle excluding SPEs.

### ***Relationship between data on stocks and flows***

Direct investment position and direct investment flows are related in that the transactions entered in the investment flows explain in part the change in the stock between periods. Direct investment flows measures net transactions with financial assets and liabilities between residents and non-residents in a direct investment relationship. The purpose is not to measure cross-border movement of capital (even though it is likely that most transactions involve the transfer of funds across borders), but rather to measure transactions between residents and non-residents. Transactions with foreign assets which take place between two residents are not included, even though the transaction may entail cross-border movement of capital. The same applies to transactions with domestic assets which take place between two non-residents. Nevertheless, such transactions can affect the entity classification of financial asset stocks because of reclassification between industries or countries.

Not all entries in the direct investment flows derive from actual transactions. In certain instances, imputed values are entered as investment flows even though no actual transaction has taken place. This is done to reflect the underlying economic relationship. The following is an example of this:

**Reinvested earnings.** See above under *The nature of direct investment*.

**Accrued, unpaid interest on liabilities.** In the case of so-called bullet bonds or other loans on which accrued interest is added to principal, interest is entered in direct investment flows as an increase in the loan, even though no actual capital flows have taken place.

The formula below shows the factors that affect financial assets in direct investment:

$$\text{Initial position} + \text{direct investment flows} + \text{exchange rate and price changes} + \text{other changes} = \text{final position}$$

Figures with a positive sign indicate an increase in financial assets, and figures with a negative sign indicate a reduction.

Apart from investment flows, the value of financial assets can change as a result of price and exchange rate movements, as well as other changes. There could be various reasons for other changes; therefore, a discrepancy between data on positions, on the one hand, and transactions, on the other, could lead to an unexplained difference. Examples of other changes are changes in legal domicile, bankruptcy, and reclassification.

## ***Valuation***

Equity holdings in direct investment are entered as own funds at book value in the accounts of the direct investment enterprise. Transactions are entered at market value.

Short- and long-term claims and obligations are entered at nominal value, apart from debt instruments, which are entered at market value.

## ***Classification system***

Direct investment is classified according to the nature of the transactions, as well as by industry and country.

## ***Nature of transactions***

Transactions in direct investment are classified according to whether they belong under transactions involving equity or loans. (For further information, see the terms and definitions above.)

### ***Industry/sector classification***

The classification of direct investment enterprises by industry is in accordance with the Icelandic industry classification system, ÍSAT2008, which is based on the system used by the European Union, NACE Rev. 2.

The classification of resident entities by industry is determined by their recorded operations according to ÍSAT2008 in the enterprise register, and non-residents are classified according to information from reporting entities.

Direct investment is published in statistics according to a rough summary presentation (A\*10 classification) with categories from NACE and ISIC are summarised into 10 aggregate categories.

### ***Classification by country***

The classification of direct investment counterparties by country is determined by the domicile of the non-resident entity engaged in a direct investment relationship with a resident.

Largest countries are included in the statistical tables. Other countries are included in the category “unclassified”.

## ***3. Integrity of data***

The integrity of the data is based entirely on correct, timely submittal of reports to the Central Bank and on sampling that covers direct investment adequately. Submitters' circumstances vary. For example, most entities cannot provide final figures until after their annual accounts have been prepared – usually 6-12 months after the end of the fiscal year. As a result, there could be a 2- to 3-year time lag before final information on transactions can be included in the statistics. However, the Central Bank collects quarterly data from

largest entities that are in FDI relationships; therefore, this time lag applies only to smaller companies.

### *Coverage*

The Central Bank attempts to gather information on external transactions from all those who engage in them. If coverage is limited, the figures are estimated based on given assumptions. On the other hand, this is not possible in all cases, primarily where the scope and expense of data collection is too great in comparison with the importance of the data concerned.

The direct investment sample is taken from operating entities' tax returns and the Register of Annual Accounts. This provides information on parties falling under the definition of direct investment. Attempts are made to have parties representing about 80% of total direct investment positions (excluding SPEs) submit quarterly reports to the Bank. Information from the majority of other undertakings (as a percentage of positions, not the number of undertakings) is received via annual reports. For smaller entities, data are compiled directly from tax returns and annual accounts. Other supporting data are used as well, if they are considered reliable. The tax return and annual accounts data for smaller entities are not as suitable for statistical reporting as those obtained directly from firms. For example, they do not contain all flows, such as loan activity or equity transactions, but they are more reliable as regards positions.

Information on SPEs is taken from the companies' annual accounts and from annual reports submitted to the Bank, if available.

Coverage of direct investment involving real estate owned by individuals (i.e., not through real estate firms or holding companies) is limited. If the property is bought through a company, however, the holding in the company is measured, not the property itself.

For entities that do not respond to the Central Bank's requests for data, estimates are prepared from older figures and other available data and adjusted for exchange rate differences. Irregular items such as dividend payments, equity securities transactions, and loan activities, are not estimated in direct investment. For filers that submit data on an annual basis, figures are estimated in the same way until their reports are received.

### *Limitations*

**Coverage:** In general, most direct investment statistics on positions have good coverage when the fiscal year has been closed out, whereas smaller entities' flows, new investment flows, real estate, and loan positions and flows between fellow enterprises are underestimated to some degree.

**Accounting methods:** If the cost price method or some method other than the equity method is used for subsidiaries and affiliates in preparing the accounts of the parent company or the group, it can cause discrepancies in equity holdings and reinvestment flows.

**Tax benefits:** Transferring capital for tax purposes is likely to have a negative impact on coverage.

**Inaccurate information:** Attempts are made to limit inaccuracies through systematic review of data and queries sent to data filers.

## ***4. Revision schedule***

The statistics observe a fixed revision schedule, where previously published figures are revised as new information is received. If new information of significance for the statistics is received, attempts are made to update the statistics as soon as possible. The revision schedule is shown in the table below.

Time	March	June	September	December
Quarters	Max. 15 quarters	Max. 4 quarters	Max. 17 quarters	Max. 6 quarters

## ***5. Publication***

Direct investment statistics are published on the Statistics pages of the Central Bank website twice a year: revised figures in March, and the first figures for the prior year plus revised figures from previous years in September. Publication takes place according to the revision schedule for balance of payments statistics.