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Issue Note: Treatment of Negative Equity Positions

Issue Note: Treatment of Negative Equity Positions[1]

This Issue Note (IN) discusses the treatment of negative equity positions in macroeconomic statistics. It follows up on the discussions that took place in the October 2023 meetings of the Advisory Expert Group on National Accounts and the IMF Committee on Balance of Payments Statistics. In these meetings, members of both groups agreed that negative equity positions may be recorded for unlimited liability entities, but they did not reach a conclusion on the recording of negative equity positions for limited liability entities. This IN recommends allowing the recording of negative equity positions as the default option and only zeroing out negative equity positions in specific cases where liability is strictly limited. In this regard, 'strictly limited liability' is referring to a situation where the shareholder and its affiliates would not suffer any other direct economic losses than the existing equity investment and would not be likely to assume any new financial obligations in the event of bankruptcy or termination of the entity. As part of this recommendation, negative direct investment equity positions should generally not be zeroed out, and negative equity positions in public corporations should never be zeroed out to avoid situations where governments could hide fiscal vulnerabilities. This principle also applies to the central bank in all economies, no matter who the formal owner is, since the government is likely to step in and bail out a failing central bank to avoid far-reaching economic disruptions. Compilers are encouraged to show negative equity positions as supplementary 'of which' items under equity assets and liabilities.

THE ISSUE

BACKGROUND

1. **The recommended valuation methods for equity positions in macroeconomic statistics can lead to negative valuations.** The six recommended fair valuation methods for unlisted equity positions are the same in the *Balance of Payments and International Investment Position Manual, sixth edition (BPM6)* (paragraph 7.16) and the *2008 System of National Accounts (2008 SNA)* (paragraph 13.71). Guidance Note (GN) D.2 on *Valuation of Unlisted Equity* reduces the number of recommended methods further to the following three: Own funds at book value (OFBV), recent transaction prices, and market capitalization (for instance, P/B-ratios). OFBV and market capitalization valuation methods can generate negative valuations while recent transaction prices will usually not be negative in cases where the investor is not liable for any losses exceeding the capital invested in the enterprises. Since listed companies are regularly traded and the investors subject to strictly limited liability, this note is mostly relevant for unlisted equity.

2. **The current macroeconomic statistical standards do not provide clear guidance on the treatment of negative equity positions.** GN D.2 identified the need for explicit guidance, and a

[1] Prepared by the *BPM7* and *2025 SNA* editorial teams.

Discussion Note (DN) on *Equity: The Case of Negative Valuations* was drafted to facilitate a discussion of the topic. The DN noted that negative asset positions can arise for other reasons than negative valuations and are recorded in the statistical accounts in specific cases. This is, for instance, the case with short positions (*BPM6*, paragraph 7.28; *2008 SNA*, paragraph A3.94) and transferable contracts and leases where the contract holder paid (or would need to pay) another party to take up the obligation (*BPM6*, paragraph 13.15; *2008 SNA*, paragraph 17.372).

3. **Previous discussions on the treatment of negative equity positions have led to different recommendations.** In the context of foreign direct investment (FDI), the IMF Committee on Balance of Payments Statistics (the Committee) agreed in 2019 that negative equity positions should be allowed to be recorded unless they can be attributed to erroneous reporting by respondents. However, the *Government Finance Statistics Manual 2014 (GFSM 2014)* (paragraph 7.173) only anticipates negative valuation of other equity for unincorporated enterprises, such as government quasicorporations, while for incorporated corporations with limited shareholder liability, the minimum value of their equity is zero.[2]

4. **The DN on negative equity recommended that negative equity valuations may be recorded for unlimited liability entities and should generally be zeroed out for limited liability entities, except for certain legal and economic cases.** The legal exceptions would include cases where investors are liable for the debts of their subsidiaries due to legal obligations, bilateral arrangements with the authorities, or following decisions of the tax authorities**.** The DN presented arguments for and against including loan guarantees as legal exceptions.[3] The DN also noted that there could be economic exceptions where negative equity should not be zeroed out despite limited liability. Since majority shareholders arguably choose the financing mix they provide to the corporations in which they participate in the form of either debt or equity, it would make sense to record negative equity (up to the amount of loans provided by shareholders) when the shareholders would be subject to loan losses in case of bankruptcy. Finally, the DN recommended that stock-flow consistency should be ensured by recording other price changes rather than other volume changes when negative equity is zeroed out.

[2] Along similar lines, in the European context, the European System of Central Banks Working Group on Financial Accounts concluded in 2019 that negative values for equity positions should not be recorded when the liability is limited, irrespective of the method used for estimation of market valuation.

[3] The DN presented two options when shareholders have provided loan guarantees to the companies that they have a stake in. This first option recommended treating loan guarantees like other legal obligations and allow for the recording of negative equity (up to the amount of the guarantee) when shareholders have provided such guarantees. The rationale for this treatment is that loan guarantees are as legally binding as other legal obligations, and there are no economic or legal reasons to treat them differently. Importantly, while this option allows negative equity to be recorded when there is a loan guarantee, it does not deviate from the general principle that the guarantee itself is only recorded when it is called. The second option recommended not allowing the recording of negative equity when the shareholders have provided loan guarantees as this, according to one of the DN authors, would represent a departure from the general treatment of one-off guarantees which are not recorded in the accounts. The *BPM7* and *2025 SNA* editorial teams recommended the first option.

PRELIMINARY DISCUSSIONS

5. **In the October 2023 meetings of the Advisory Expert Group on National Accounts (AEG) and the Committee, members discussed the treatment of negative equity valuations and unanimously agreed that negative equity positions may be recorded for unlimited liability entities.** Most members also agreed that stock-flow consistency should be ensured through the recording of other price changes rather than other volume changes if negative equity is zeroed out. Due to the strong support for these recommendations, these aspects will not be revisited.

6. **AEG and Committee members expressed different views on the recording of negative equity for limited liability entities.** Most AEG members agreed with the DN recommendation that negative equity should be zeroed out for limited liability entities, except for the legal and economic cases described above. At the same time, there were mixed views among AEG members whether loan guarantees should be included under legal exceptions. In the Committee meeting, many members called for an expansion of the cases where negative equity should be allowed. It was highlighted that, in the case of FDI enterprises, the direct investor often takes on the financial obligations of its affiliates for reputational reasons, implying that implicit guarantees usually exist. It was added that this is equally applicable for domestic-to-domestic relationships (including by governments). Some members also mentioned that it is difficult to distinguish the legal form of FDI enterprises (i.e., unlimited versus limited liability) in practice, particularly in the case of outward FDI (i.e., for foreign companies), which could lead to further asymmetries between investor and investee companies. Moreover, some members saw a need to specifically address the treatment of negative equity for central banks. Finally, most Committee members supported treating loan guarantees like other legal obligations and allowing for the recording of negative equity—up to the amount of the guarantee—when affiliates have provided such guarantees.

7. **Against this background, the *BPM7* and *2025 SNA* editorial teams have drafted this Issue Note (IN), which lays out several options and provides a recommendation for the treatment of negative equity valuations for limited liability entities.** The OECD Working Group on International Investment Statistics (WGIIS) has also been consulted, and they have provided a background document that touches upon conceptual and practical issues as well as materiality. This background document has been inserted as Annex II.

OPTIONS

8. **This section presents four different options for the treatment of negative equity valuations in case of limited liability entities.** The four options are briefly described below.

- **Option 1: Always zero out negative equity**
  - This option is similar to the approaches described in *GFSM 2014* and adopted by the European System of Central Banks Working Group on Financial Accounts in 2019.

- **Option 2: Never zero out negative equity**
  - This option is similar to the approach adopted for FDI equity by the Committee in 2019.
- **Option 3: Zero out negative equity, except for certain legal and economic cases**
  - This option does not allow for the recording of negative equity as the default option. It is similar to the approach described in the DN on negative equity where the legal and economic exceptions are further elaborated. There could be two versions of this option: One that would allow for the recording of negative equity when the shareholder has provided loan guarantees to other creditors of the entity that they have a stake in, and another that would not.
- **Option 4: Do not zero out negative equity, except for specific cases where the shareholder's and its affiliates'[4] liability is strictly limited to the existing equity investment**
  - This option allows for the recording of negative equity as the default option. Negative equity could be zeroed out only in specific cases where the shareholder's and its affiliates' liability is strictly limited in the sense that they would not suffer any other direct economic losses than the existing equity investment and would not be likely to assume any new financial obligations in the event of bankruptcy or termination of the entity. Examples of other direct economic losses include loan losses and the realization of guarantees, while the willingness to assume new financial obligations could be related to reputational, societal, or other reasons.

RECOMMENDATION

9. **There are arguments for and against all four options.** Options 1 and 2 would be relatively easy to implement, but they do not allow for any flexibility and are eliminated because it is important to be able to distinguish cases where liability is strictly limited from cases where it is not. Option 3 would provide flexibility, but most Committee members as well as the WGIIS have called for an expansion of the cases where negative equity should be allowed. In this context, it is worth noting that a strict application of Option 3 could lead to the recording of inflated equity assets that would not reflect economic reality. For instance, a government could let essential public corporations such as an electricity plant or railway company stay in business with considerable negative equity positions and fund them with loans from a state-owned bank. Such arrangements would ultimately be based on implicit government guarantees, and the government's balance sheet would not reflect economic reality if negative equity in these public corporations were to be zeroed out. Another example would be a well-known MNE that has an FDI enterprise with negative equity, but where the MNE has a history of restoring capital in its affiliates for reputational reasons.

[4] Affiliates are entities in an immediate or indirect direct investment relationship with each other or that have the same immediate or indirect direct investor.

10. **Based on this process of elimination, the *BPM7* and *2025 SNA* editorial teams recommend Option 4, i.e., allowing the recording of negative equity positions as the default option and only zeroing out negative positions in specific cases where liability is strictly limited.** In this regard, strictly limited liability is referring to a situation where the shareholder would not suffer any other direct economic losses than the existing equity investment in case of bankruptcy and would not be likely to take on any financial obligations because there are no implicit guarantees or significant reputational risks. To provide operational guidance, it can generally be assumed that implicit guarantees or significant reputational risks exist when a shareholder's ownership share is at least 10%. This implies that negative direct investment equity positions should not be zeroed out unless a specific direct investor has no legally binding economic obligations, except for the existing equity investment, and a history of not assuming any new financial obligations in the event of bankruptcy or termination of its direct investment enterprises.[5] Moreover, under this option, negative equity positions in public corporations should never be zeroed out to avoid situations where governments could hide fiscal vulnerabilities. This principle also applies to the central bank in all economies, no matter who the formal owner is, since the government is likely to step in and bail out a failing central bank to avoid far-reaching economic disruptions.

11. **Compilers are encouraged to show negative equity positions as supplementary 'of which' items under equity assets and liabilities.** This would give users information about the magnitude of the issue and could be useful for analytical purposes. For instance, some users may want to treat negative assets as liabilities and would be able to rearrange the balance sheet if information about negative assets is available.

12. **It is important to underscore that the recommended option is fully in line with the fundamental principles of macroeconomic statistics.** The recording of negative equity positions for limited liability entities reflects the fact that shareholders will need to pay an amount of money if they want to avoid any kinds of obligations related to ownership at a certain point in time.[6] Even if it turned out that a shareholder did not incur any losses when a limited liability entity defaulted and the amount had not been

[5] In case some shareholders are zeroed out while others are not, the latter would only record negative equity proportional to their ownership share. A difference in treatment across shareholders is also observed in other areas within macroeconomic statistics, e.g., for direct investors versus portfolio investors where reinvested earnings are only calculated for the former. Additionally, the term 'zero out' could also cover cases where a shareholder's equity is not adjusted all the way to zero. For instance, this could be the case if a shareholder has provided a loan of 100 and has a 5% equity share that is worth -200. In the absence of implicit guarantees and significant reputational risks, an equity position of -100 should be recorded, which would be equal to value of the loan and therefore the additional loss incurred by the shareholder in case of bankruptcy.

[6] It could be argued that negative equity positions should be seen as contingent assets/liabilities—which are not part of the core framework in macroeconomic statistics—since the negative positions could turn positive at a later stage due to increased profitability or other factors. However, the *BPM7* and *2025 SNA* editorial teams note that fair valuation methods should be used to estimate the market-equivalent value of nontraded equity at a specific moment in time. In this regard, the inclusion of negative equity positions is no different from including positive equity positions for nontraded equity since positive positions could potentially also turn negative in the future.

zeroed out, the valuation adjustment to zero could be made at the time this is known to the compiler.[7] This treatment would be similar to the treatment that is applied when information about a recent transaction price becomes available and differs from the valuation that had previously been recorded.

INITIAL CONSULTATION

13. **A draft version of this IN has been sent to WGIIS and the IMF Government Finance Statistics Advisory Committee (GFSAC) for initial consultation to facilitate the decision ultimately taken by the AEG and the Committee.** A summary of the responses is shown in Annex III. Overall, there was strong support for the recommendations presented in the draft version of the IN. Only a few members saw a need to adjust the IN, and their comments mostly focused on three issues. These issues and the responses from the *BPM7* and *2025 SNA* editorial teams are listed below.

- **Issue 1: Consider recording a positive liability instead of a negative equity asset.**
    - Response from the editorial teams: While this issue was not raised in the AEG and Committee discussions in October 2023, the editorial teams recognize that some—particularly GFS compilers—prefer the recording of a positive liability instead of a negative asset. At the same time, the editorial teams note that the recording of negative equity assets is also done in other cases, e.g., for short positions. As a compromise solution, the IN encourages compilers to show negative equity positions as supplementary 'of which' items under equity assets and liabilities, which would give users the possibility to rearrange the balance sheet for certain kinds of analyses.
- **Issue 2: Provide clear guidance on the cases where negative can be zeroed out.**
    - Response from the editorial teams: To avoid judgment in deciding whether implicit guarantees or reputational risks exists, operational guidance has now been included in the IN. It states that implicit guarantees or significant reputational risks are generally assumed to exist when a shareholder's ownership share is at least 10%. This implies that negative equity in a direct investment enterprise should usually not be zeroed out.
- **Issue 3: Avoid reference to "SOEs."**
    - Response from the editorial teams: The IN now refers to the well-defined statistical concept "public corporations" rather than "SOEs."

[7] This impact is expected to be limited in practice. Based on Danish data, Damgaard and Elkjaer (2014) find that, while almost 15% of unlisted FDI enterprises display negative OFBV, it only makes a small difference on the macroeconomic level whether these negative positions are included in FDI statistics since there is a limit to how negative OFBV can get before a company is liquidated or the equity is restored to stay in business.

Question for AEG and Committee members

1) *Do members agree with the recommendation proposed by the* BPM7 *and* 2025 SNA *editorial teams, i.e., allowing the recording of negative equity positions as the default option and only zeroing out negative positions in specific cases where liability is strictly limited?*

Annex I. References

REFERENCES

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Annex II. Note from the OECD Working Group on International Investment Statistics (WGIIS)

Outcomes of the OECD WGIIS Surveys on Negative Equity

BACKGROUND

A first draft of the IMF-ECB Discussion Note (DN) recommended that negative valuation of equity may be recorded for unlimited liability entities and should generally be zeroed out for limited liability entities, unless legal or economic exceptions apply. At the IMF Committee on Balance of Payments Statistics (BOPCOM) meeting on 24-26 October 2023, several BOPCOM Members raised both conceptual and practical concerns about the proposed treatment, and as a result, BOPCOM asked the OECD to consult its Working Group on International Investment Statistics (WGIIS) to gather feedback on the conceptual integrity, feasibility and materiality of the tentative decisions proposed.

This note will first describe the key points mentioned in the DN, followed by the results of two online surveys launched by the OECD to collect the evidence required to react to BOPCOM's request. The last section will present the conclusions and propose a possible solution.

KEY ISSUES COVERED IN THE DISCUSSION NOTE

The starting point of the DN was that limited liability protects investors from losses exceeding the value of their invested capital, and hence, that it was not meaningful to record negative equity in limited liability companies as the Direct Investor (DI) would not be liable for all the debts and obligations of its Direct Investment Enterprise (DIE). This implied that FDI compilers should be able to differentiate limited from unlimited liability companies among the various foreign affiliates incorporated in their economy, but also being able to identify the legal form of the affiliates abroad owned by their resident parents.

While the default assumption was to zero out negative equity for all limited liability companies, two exceptions were proposed. An exception of legal nature would apply to the general proposal of zeroing out negative equity when investors may be liable for the debts of their subsidiaries due to legal obligations, bilateral arrangements with the authorities, or following decisions of the tax authorities.

The DN also recognised that negative equity might also reflect financing decisions by multinational enterprises (MNEs). Hence, the DN included an exception to the zeroing out of negative equity of economic nature. This would apply when the non-equity liabilities of a limited liability entity exceed its assets, and thus, negative equity could be recorded up to the amount of loans provided by shareholders, when the latter would be subject to loan losses in case of bankruptcy.

OUTCOMES OF THE OECD SURVEYS

The first survey, covering conceptual and practical aspects of the proposed treatment. The survey was completed by 36 WGIIS countries, including eleven non-OECD member countries from South America, Europe, Africa, and Asia. The second survey on current practices and empirical evidence was completed

by 34 countries, 11 of which were non-OECD member countries covering similar regions. Both surveys ran from 17 November 2023 to 5 January 2024.

PRACTICAL AND CONCEPTUAL CONCERNS

Limited versus unlimited liability companies

According to the evidence gathered from the OECD WGIIS, one respondent in three (12 out of 36) is not able to differentiate between limited and unlimited liability corporations on the liability side, since such information is not available in their collection system. Some countries did report that unlimited liability companies are very rare in their economies.

On the asset side, only two respondents explicitly said that they can differentiate the legal form of affiliates abroad but only with considerable delay. This implies an asymmetric treatment of negative equity between assets and liabilities.

Furthermore, the survey found that it is rather uncommon that the parent does not step in to cover the debts of its affiliate (only four out of 36 countries report this happening); the parent will want to avoid the reputational damage that would ensue from such event. There was also little evidence pointing to affiliates leaving the FDI universe because of bankruptcy due to negative equity.

Application of the legal exception

The survey showed that only three out 36 countries would be able to assess exceptions of legal nature. Aside from being resource intensive, courts decisions or similar actions will only be made available with a significant time lag. Similar information would not be easily available for affiliates abroad. Loan guarantees would only be identifiable if these are disclosed in the financial accounts of the affiliate.

Application of the economic exception

Less than a third of the respondents (11 out of 36) would be able to implement the exception of economic nature. While the presence of debts to the parent (or also to fellow enterprises) to back up negative equity in the affiliate is a rather common occurrence in all sectors of the economy. In some countries, this is even more frequent for affiliates engaged in exploration and extraction activity, where the business model is such that these affiliates remain alive only through debt flows from the foreign parent company. This fact is widely observed in OECD and non-OECD member countries of the WGIIS.

Several countries expressed strong support for this exception because negative equity should not be regarded in isolation from other components. Large intra-company loans are frequently observed while affiliates suffer significant losses (via negative reinvested earnings (RIE), which eventually turn equity negative).

Since more than two in every three countries will not be able to apply this exception, it would be crucial to maintain the recording of negative equity. In fact, because of the very substantial loans obtained by these affiliates, zeroing out negative equity would exaggerate FDI positions; thus, it is economically and analytically relevant to preserve negative equity since it signals probable financial engineering by the parents, and it would be unfortunate to lose such information for those that could not identify this exception and choose to zero out the equity.

Additional practical concerns

The survey also revealed the following concerns about the feasibility of the suggested treatment:

a) the exceptions are not so exceptional: for several countries, the largest cases of negative equity would fall under both exceptions and so not zeroed out; therefore, the default option should be to keep negative equity, and only zero out when compelling reasons exist.

b) high implementation cost: a consistent implementation of the exceptions would be prohibitively expensive, lengthy and need considerable resources. Assessing if the exceptions apply might be very time-consuming for both the compiler and the respondent (with no guarantee that the latter will provide the correct information). It would be best to reverse the burden of proof to reduce the impact on compilers and respondents, again, by allowing negative equity as the default option.

c) timeliness: much of the information needed to apply the exception of legal nature is only available with a considerable time lag, affecting, therefore, the timeliness of the correction. This is problematic in countries with strict revision policies.

d) asymmetries: it will be extremely difficult to zero out negative equity on the outward/asset side. Assessing the legal form of affiliates abroad (e.g., by using the company name) in a variety of jurisdictions is not straightforward, nor is retrieving information on court cases.

e) legal framework: the law of some countries is such that unlimited liability companies are very rare, do not exist or are not surveyed. Domestic private law in other countries mandates resident public limited companies to have a (positive) lower bound for the equity recorded in their books. If the amount of equity falls below this threshold, shareholders are required to inject new capital in the company.

f) identifying valid thresholds: in many countries, the majority of the negative equity stock is made of a very large number of small cases, rendering the application of the exceptions only possible for the largest positions; however, it is not clear how to set a threshold that is objective and applicable across countries to limit the potential for further asymmetries.

g) revision period: guidance will be needed to explain at what point countries will need to zero out negative equity, e.g., whether when it occurs or after a number of years of consistent negative equity. It would be also important to explain how to reconcile balances between periods (i.e., if with the first vintage of data or the final one). Guidance would also be required to clarify how to treat cases where negative equity is zeroed out in one period, and the DI subsequently provides financial support in the following period.

Conceptual concerns

The survey asked if the respondents agreed with the proposal to zero out negative equity with the exceptions illustrated in the DN or if additional exceptions would be needed or if there were conceptual concerns with the proposed treatment.

19 out of 36 countries agreed with the proposed treatment, but of those 19, six cannot apply either exception (legal nor economic) or cannot tell apart limited from unlimited liability companies. Another seven are already zeroing out negative equity, hence it would be expected that they would have chosen this answer. In the end, of those that were in favour of the proposed treatment, only five out of 36 respondents can differentiate between limited and unlimited liability companies on the liability and/or asset side and apply

either or both exceptions. The remaining 14 countries that opted for the proposed treatment, are currently zeroing or would eventually zero out all of the negative equity tout court, with all the implications discussed above and further elaborated below.

It is also important note that about a dozen countries have voiced conceptual concerns with the proposals and that they do not agree to zero out negative equity. Not surprisingly, these are the countries where negative equity is frequently observed and accounts for non-negligible shares of the total DI liability position. Among the various comments in favour of keeping the status quo (not zeroing out negative equity), the following are worth reporting:

- Each time compilers investigate a case of negative equity with the reporting entity, they receive reasonable explanations.
- The elimination of negative equity might lead to misinterpretations and reduce transparency of local business conditions. Accurate financial reporting enhances market confidence and credibility.
- Zeroing out negative equity will distort economic reality as it will artificially increase a country's net IIP.
- While form of legal organisation may be relevant for negative equity in portfolio or other investment functional categories, it is irrelevant to the discussion of negative equity for direct investment. FDI statistics should reflect economic reality for data users, regardless of whether the position is positive or negative, to provide them with the most accurate statistics on cross border investment by multinational enterprises.
- Bilateral asymmetries will increase as a result of difference in treatment between the country of the parent entity and the country of the affiliate due to the asymmetric availability of information to compilers.

Lastly, only two countries flagged that more exceptions would be needed. One highlighted the role of the government participation in public limited liability companies as a kind of implicit guarantee (because the government will not let them go bankrupt). Moreover, there are cases where implicit guarantees are offered not only by direct shareholders but also any other related entities of the global group. Another country suggested to also account for cases of negative equity in central banks.

CURRENT PRACTICES AND EMPIRICAL EVIDENCE

The main outcomes of the survey on current practices and empirical evidence are:

- Only 9 WGIIS countries out of the 34 that filled in this survey zero out negative equity on the liability side. All but two do so also on the asset side. No relevant exceptions are applied to this practice.
- About half of these 9 countries do not back-cast the zeroing out of negative equity, which implies a break in the time series, and hence, interpretability issues. One of those that back-casted the series, estimated that, in 2016, this change had a global impact on the IIP of -2.1% of the GDP.
- For most of these 9 countries, negative equity was not very frequent (occurring in less than 5% of all the companies surveyed, and mostly resulting in a mix of small and large companies) and it accounted for less than 5% of total FDI liabilities.

- Nonetheless, negative equity is not so rare even among the other countries that do not zero it out (happening in at least 15%, and occasionally even higher than 25%, of all companies surveyed). While for most countries, negative equity accounts for up to 5% of total FDI liabilities, there are some for which it can go up to 15%.
- While these might seem like small shares, we are still talking, in some countries, of billions of USD of negative equity. Indeed, the value of UK FDI associated with negative equity was nearly GBP 50 billion for both FDI liabilities and assets in 2021; in the case of the US, negative liabilities equity amounted to USD 222 billion in negative equity positions in 2022.
- In more than half of the cases, countries that observe negative equity positions also observe positive intercompany debt positions, leading in most cases to positive FDI liabilities for the company overall.

CONCLUSIONS

To sum up, the consultation of the OECD WGIIS community confirmed the views expressed by several BOPCOM Members at the October meeting. There are several valid reasons to record negative equity (see Borga, 2019), and setting it to zero will alter the economic reality that FDI statistics are meant to portray, by hiding MNEs financing patterns and artificially increasing a country's net IIP.

Moreover, while the exceptions proposed are important, their implementation is far from practical: it is difficult to differentiate limited from unlimited liability companies (and nearly impossible on the asset side); the application of both exceptions would be extremely resource-intensive and likely to increase respondent burdens (and again, unfeasible on the asset side); the absence of a clear approach with objective thresholds across countries to identify “large enough” cases is bound to further increase asymmetries; and for those that can implement them, the exceptions would generally be the norm, meaning that considerable negative equity would remain in the statistics.

Therefore, considering the conceptual concerns on the proposed approach and the widespread inability of implementing either or both exceptions proposed, with consequent negative impacts on FDI statistics, the OECD strongly recommends maintaining the status quo – i.e., do not zero out negative equity as the default option for both limited and unlimited liability companies, and only do so for very well-defined cases that would be easily implementable. These cases could be limited to:

a) mismeasurement or misreporting by the respondent. In some cases (notably for quasi-corporations), the reporter may not have full financial records to base its reporting on but, instead, must estimate the values. In other cases, these errors might come from the reporting system. Countries already contact the reporter to confirm or correct negative values.

b) affiliates that are liquidated. Affiliates with negative equity that are undergoing bankruptcy or restructuring procedures, and are hence liquidated, will have negative equity set to zero against positive price changes, but will only be done once the procedure is over.

Annex III. Consultation of the OECD Working Group on International Investment Statistics (WGIIS) and the IMF Government Finance Statistics Advisory Committee (GFSAC) on the Draft Issue Note

WGIIS Consultation

SUMMARY

- Most of the respondents agree with the conclusions and strongly support option 4; the whole note is well supported by the evidence. This includes the material that the WGIIS shared with the *BPM7* and *2025 SNA* editorial teams from the WGIIS surveys, but also the wider context of state-owned enterprises.
- One respondent asked if there is anything more that could be done to strengthen the reasons why option 1 and option 2 are not being considered beyond the inflexibility of each.
- One respondent suggested including a fifth option: zero-out equity and create a liability of the shareholder and asset of the company with negative own funds.
- One respondent raised the need for an operational definition of 'strictly limited liability.'
- One responded requested guidance on the treatment in cases where the equity for some shareholders is zeroed out but not for others.

GFSAC Consultation

SUMMARY

Number of responses: 13

Responses by option:

Option 1	*Always zero out negative equity*	*1*
Option 2	*Never zero out negative equity*	*0*
Option 3	*Zero out negative equity, except for certain legal and economic cases*	*1*
Option 4	*Do not zero out negative equity, except for specific cases where the shareholder's and its affiliates liability is strictly limited to the existing equity investment*	*9*
*Other**	*Negative equity to only be recorded to the extent the shareholder has incurred any legal or constructive obligations or made payments on behalf of the affiliate*	*2*

** The respondents who answered "other", argued that Option 3 and Option 4 were largely a mirror of each other and proposed to merge the two options into the single option shown in the above table.*

There was a clear majority support from GFSAC members for Option 4 (see table).

However, GFSAC members did raise several important points for the consideration of the authors of the Issue Note. These include:

i) An observation that the inclusion of a negative equity asset (instead of a positive liability) in the shareholders' accounts may not best reflect the economic situation, and other alternatives should also be considered.

a. "It is our understanding that according to International Public Sector Accounting Standards, the negative equity asset of reporting units is recognized but it is rather presented as an explicit liability of the holder of the equity asset (i.e., in the place of a negative asset, a liability is recognized by the owner of the equity). In the interest of harmonization with international accounting standards, I would recommend that also this alternative treatment of the negative equity should be considered. It has the added

benefit that it clearly makes a distinction between the cases where positive equity is recorded and the cases where negative equity exist. Also, since it will be included in the holder's (government's) liabilities, measures to better manage these liabilities will result as a policy decision."

b. "I am also wondering whether the constructive liability in this case should be reflected as a negative asset or a positive liability. In that regard, it seems that the line of reasoning for option 4 implies that most subsidiaries cannot have negative net worth, but that this will always lead to some kind of implicit claim on the shareholder. This may be reflected via a negative equity holding, but like with pension funds, it may also be considered to record a kind of 'claim on the shareholder' on the asset side of the balance sheet of the subsidiary and on the liability side of the shareholder. This may better reflect economic reality than recording a negative asset and it may lead to more comparable results across countries (e.g., a negative asset for the government will not be reflected in its gross debt measure, whereas a liability will; allowing a recording of negative equity holding may then still provide governments with a way to manipulate their gross debt levels)."

c. "If we choose the option to report negative equity liabilities in public corporations, the question is whether the same treatment goes to equity financial assets as counterpart of negative equity liabilities."

d. "In my opinion, by recognizing a "negative asset" in the shareholders' accounts not only it does not reflect the economic reality (a "negative asset" is in substance a liability), but also it may be misleading to users of statistics."

ii) The importance of clearly and precisely defining the guidance, whether it be the exceptions when negative equity is not to be recorded or the circumstances when it should be recorded.

a. "I have the feeling that the main difference between options 3 and 4 is that option 3 only recommends to recognize negative equity for limited liability entities in case there are clear legal (and 'economic') obligations, whereas option 4 argues that there will often be additional implicit obligations in case of limited liability entities that should be recognized on the balance sheet. The latter seem to come close to what is currently referred to as 'constructive liabilities' in the 2008 SNA….. In that regard, if my interpretation is correct that the main conceptual argument for accepting negative equity as the default option relates to the fact that the relevant shareholders have constructive liabilities, it would be important to clearly define and delineate these types of liabilities in the forthcoming manuals."

b. "This is one of the cases where the legal form may point to one outcome (and will be used by governments to not acknowledge their potential liability), while the economic substance (or in accounting speak the constructive obligation) may lead to another outcome. Very clear and precise guidelines will be the only way to avoid such issues."

iii) A suggestion to avoid reference to "SOEs".

a. "Option 4 seems to include within its scope a special treatment of never zero out negative equity of State-Owned Enterprises (SOEs), which the term not only is not defined nor described in SNA and BPM, but also may have different meanings across the world (encompassing only subsidiaries or encompassing subsidiaries and associates). A clarification may be warranted on the exact scoping of entities covered by the Issue Note and Option 4."

b. "Since SOEs do not have a standardized definition, the term is applied differently in various countries, and the term are not a recognized concept in the statistical basis of reporting, I would recommend the authors to avoid the use of this term and rather refer to public corporations which is a standard concept in the macro-economic statistical reporting."