

Overseas portfolio investment: the Bank of England's enquiry into transactions in sterling securities

Introduction

An important series of transactions which affect the United Kingdom's balance of payments are those, known collectively as portfolio investment, involving the purchase or sale of overseas securities by U.K. residents (outward investment), and of U.K. securities by overseas residents (inward investment). The Bank have looked at ways and means of improving the information regarding such transactions in sterling securities, and at the beginning of 1969 an experimental enquiry was instituted with the co-operation of the British Bankers' Association, the Accepting Houses Committee, the British Overseas and Commonwealth Banks Association and the Council of the London Stock Exchange. This scheme was made permanent in June 1970 and the other banks in the United Kingdom, including the foreign banks, also agreed to join in.

As regards outward portfolio investment, adequate information about U.K. residents' investments in foreign currency securities comes from reports made to the exchange control by banks, brokers and other authorised depositaries; but information about U.K. investment in overseas sterling securities was,¹ until the enquiry, becoming increasingly unsatisfactory. Where there were U.K. registrars or paying agents of such securities, the Bank obtained half-yearly figures of the nominal level of U.K. residents' holdings. These figures were usually compiled on the assumption that holdings were U.K. owned if interest or dividends were paid net of U.K. tax at the latest dividend date. This was not a wholly reliable method of distinguishing between U.K. and overseas holdings. There were also other drawbacks: the estimates were infrequent; they were not altogether consistent (since dividend dates varied widely between securities); and, more important, cash flows could only be roughly estimated by applying average market prices to the nominal changes. But the main disadvantage of this system was that it failed to cover the increasing number of new issues in overseas sterling countries for which there are no registrars or paying agents in this country.

There were also defects in the data collected on inward portfolio investment. Reasonable estimates of overseas investment in British government stocks could be compiled from the Bank's own records, supplemented by returns from the banks concerning holdings through bank nominees. But overseas investment in U.K. local authority and company securities was less well documented. In particular, estimates of overseas investment in company securities depended on a survey of some 200 large companies undertaken by the then Board of Trade. These estimates took holdings through certain nominees into

¹ "Overseas sterling securities" in this article means overseas securities denominated in sterling or sterling area currencies.

account, although incompletely, and were throughout in nominal values, so that the problem of deriving cash flows existed here also. The survey did not supply much information about the country of residence of the overseas investors.

The pilot scheme

The aim of the scheme was to obtain market information about transactions in sterling securities. For inward investment, details were needed of purchases and sales of U.K. sterling securities effected on behalf of overseas residents. For outward investment, the requirement was more complicated. A bank or broker acting on behalf of a U.K. resident is often unaware of the identity of the other party to the deal. It was not therefore possible to ask for details merely of those transactions in overseas sterling securities which involve both a U.K. and an overseas resident. Instead the Bank asked for details of all transactions which directly involved an overseas resident *i.e.* a transaction by an overseas resident through a bank or broker in the United Kingdom, or a transaction by a U.K. bank or broker (or jobber) in an overseas market. Transactions between two overseas residents should cancel out and the resulting net amount of overseas transactions should represent deals done by U.K. residents.

Many transactions are channelled through both a bank and a broker in the United Kingdom, the bank passing the initial order on to a broker; in such cases the broker does not necessarily know whether the bank is acting for a U.K. or an overseas customer, nor does the bank necessarily know whether the broker (or jobber) executes the order in the United Kingdom or in an overseas market. To avoid the danger of double counting it was decided that reporting would be done by the U.K. bank, broker or jobber who was in direct contact with the overseas party to the transaction.

Under the original arrangements, contributors agreed to provide information concerning transactions exceeding £50 in value in all types of U.K. and overseas sterling securities. The forms used for reporting were simple 'tickets' on which details of individual transactions, or groups of similar transactions, could be entered when other documentation was done.

Two types of forms were used. One covered all transactions in U.K. or overseas sterling securities, whether effected in the United Kingdom or overseas, in which a U.K. bank or broker acted on behalf of a customer or client with an overseas address. The second covered all transactions, whether on behalf of U.K. or overseas residents, in which a reporting bank, broker or jobber executed an order in an overseas market. Overseas residents' transactions in U.K. securities, which are classified as inward investment/disinvestment, would almost always appear on the first type of form. On the other hand, U.K. transactions in overseas securities, which are classified as outward investment/disinvestment, could be reported on both types of forms. U.K.

outward investment may in practice consist either of U.K. purchases of overseas securities in London from overseas residents (in which case the overseas residents' sales would be reported on the first type of form) or of U.K. purchases of overseas securities executed in overseas markets (in which case they would be reported on the second type). Where a U.K. intermediary buys or sells in an overseas market to carry out an order received direct from an overseas customer there would be entries on both forms which should cancel out.

Both forms ask for much the same kind of information: the date of the bargain; the nature of the transaction (purchase, sale, subscription to new issue, collection of redemption proceeds); the title of the security; the country of the overseas party to the transaction; and the consideration (ignoring charges etc.) received or paid. An "overseas resident" is defined simply as someone, including a bank or broker, with a permanent overseas address. The identity of the customer or client is not disclosed, so that the scheme does not in any way infringe on the confidentiality of contributors' business.

The permanent scheme

In the light of experience with the pilot scheme, some modifications were made when the scheme became permanent in June 1970. First, it was decided that transactions in British government stocks should be excluded. Satisfactory information could be obtained from the Bank's stock registers, now fully computerised, and, for nominee holdings, from the commercial banks; it was therefore unnecessary to trouble the market. Secondly, it became evident that the minimum value of transactions could be raised from £50 to £250 without affecting the statistics to a significant extent. Thirdly, it was agreed that where a contributor both received an overseas order and effected it in an overseas market there was no need to report either leg of the transaction. Fourthly, although the scheme was geared to the reporting of individual transactions, contributors who preferred to do some aggregation themselves were allowed to use an alternative type of return. This meant some loss of detail because, for example, one form might provide a single figure for purchases of all U.K. ordinary shares on behalf of residents of all E.E.C. countries. Contributors are free to use either or both types of return, as suits them best from time to time. They may also, subject to prior arrangement, provide the required information in the form of computer print-outs or other documents arising from their normal accounting procedures (e.g. copies of contract notes from which confidential details, such as the customer's name and address, have been expurgated).

The scheme in its permanent form was extended to the American and Japanese banks in London, members of the Foreign Banks and Affiliates Association and the remaining U.K. and overseas banks. Consideration was also given to the inclusion of members of provincial stock exchanges and

unit and investment trusts. The provincial stockbrokers were found to do very little direct overseas business and were, therefore, not asked to report. Investment and unit trusts were also not included because they placed nearly all their deals in overseas sterling securities through U.K. banks and brokers rather than directly abroad. It was decided to exclude London offices of overseas stockbroking firms in future, since their inclusion had led to some double-counting; contributors were now asked to regard them as overseas residents.

Apart from probably missing some direct dealing in overseas markets, the enquiry still has certain other defects. Redemptions and subscriptions to new issues are not being fully reported, although most large overseas holdings of U.K. securities and U.K. holdings of overseas securities are probably held through U.K. banks or their nominees. It may be that the absence of a specific 'bargain' makes the identification of such items difficult for contributors. Hence, when issues or redemptions occur, reference is still made to records kept by the Bank and by other registrars concerned with the issue or redemption of overseas sterling securities. Another deficiency arises where an overseas investor acts through a U.K. agent e.g. a solicitor or accountant, and the agent instructs a bank or broker without revealing the overseas residence of his principal. It is not practicable to widen the scope of the enquiry to include all who may sometimes act for overseas principals in this way; or to expect contributors to seek out possible overseas interests in business done for U.K. customers or clients. The best that can be done is to ask contributors to report any order received from a U.K. resident who is definitely known to be acting on behalf of an overseas resident. There may also be some inevitable overlap with the direct investment enquiry of the Department of Trade and Industry. This could occur, for example, where dealings reported by banks and brokers under the portfolio enquiry are regarded by their clients, some of whom might be overseas companies, as being in the category of trade investments, which are covered by the direct investment survey. It is, however, possible to keep watch for major company take-overs which occur by means of purchases in the market, although identifying these in the enquiry can be difficult where information concerning individual securities is lost through aggregation.

Inward investment

The following table gives figures for overseas investment in the sterling securities of U.K. companies obtained from the portfolio enquiry. It includes transactions on behalf of customers of the Bank of England and certain other official agencies. These figures have been used in the compilation of the official balance of payments from the third quarter of 1969 onwards.¹

¹ See Table 15 of the article on the U.K. balance of payments in the September 1971 issue of *Economic Trends* where the figures appear under 'Overseas investment in the U.K. private sector: other company securities'. The figure in *Economic Trends* for the third quarter of 1970 also includes a special issue of shares in connection with a U.K. take-over of an American company.

Overseas investment in the sterling securities of U.K. companies^a

£ millions

Net Inward investment +/disinvestment —

	1969				1970				1971		
	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Non-sterling countries											
North America	+12.2	+44.8	+17.9	+24.0	-0.3	-0.7	-0.5	+3.9	+11.3	+3.8	+1.3
E.E.C.	-3.0	-0.6	+5.0	+11.0	+6.6	-4.4	-3.1	-1.5	+8.9	+23.8	+1.2
Other W. Europe	+0.3	-1.8	-4.4	+8.7	+11.5	-7.4	-3.7	-6.3	+6.7	+24.4	+0.5
Other	-0.2	+0.5	+0.2	+0.2	+0.3	+0.9	+0.3	-0.4	+0.4	-0.1	+0.4
	+9.3	+42.9	+18.7	+43.9	+18.1	-11.6	-7.0	-4.3	+27.3	+51.9	+3.4
Overseas sterling countries											
Developed ^b	-0.2	+1.5	+0.8	-1.3	-5.1	-1.3	+0.2	-1.0	-1.4	-1.5	-0.9
Other	-0.6	-1.5	+7.0	-8.2	-6.4	+3.5	-0.3	+7.1	+11.3	+12.8	+4.7
	-0.8	—	+7.8	-9.5	-11.5	+2.2	-0.1	+6.1	+9.9	+11.3	+3.8
Total	+8.5	+42.9	+26.5	+34.4	+6.6	-9.4	-7.1	+1.8	+37.2	+63.2	+7.2

^a Fixed interest and ordinary.

^b Australia, New Zealand, South Africa, Irish Republic.

During 1969 substantial net overseas investment in U.K. company securities was mostly by North American investors; it included large buying of U.K. oil shares. In 1970 there was a small net overseas disinvestment on a declining market. Net overseas buying recovered strongly in the first half of this year, particularly by investors in E.E.C. countries and Switzerland, but it was not maintained in the third quarter. Transactions by sterling area investors have generally not been important, except for those by a small number of official holders.

Approximate figures of turnover (*i.e.* the total of purchases and sales) are available in the case of U.K. company securities, *viz.*:

£ millions

	1969				1970				1971		
	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
North America	23	74	36	44	22	17	15	12	16	17	25
E.E.C.	18	17	11	23	27	17	17	17	26	65	79
Switzerland	28	22	13	21	31	18	9	11	14	44	52
Other	48	36	34	27	39	30	28	35	36	67	76
Total	117	149	94	115	119	82	69	75	92	193	232

Overseas transactions in U.K. local authority stocks, which are also covered by the scheme, have been very small.

Outward investment

The table below gives figures of U.K. investment in overseas sterling securities drawn from the portfolio enquiry, together with those of U.K. participation in new issues and redemptions of overseas sterling loans on the London market. It covers all types of securities, and the total is divided between government and municipal securities and those issued by companies.

U.K. investment in overseas sterling securities^a

£ millions

Net outward investment —/disinvestment +

	1969				1970				1971		
	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Portfolio enquiry											
Voluntary programme countries^b											
Australia	-6.6	-1.8	+7.1	-5.4	-7.4	+6.8	+4.9	+0.8	+2.8	+2.4	+0.5
New Zealand	+0.5	+0.4	+0.4	-0.2	+0.1	+1.2	—	—	-0.2	+0.1	+0.1
South Africa	+6.6	+10.6	+7.3	+6.1	-2.7	+1.5	-0.1	-5.2	+7.0	+5.0	+0.6
Irish Republic	+0.3	+0.2	+0.1	—	—	+0.1	+0.2	+0.2	+0.2	+0.2	-0.1
	+0.8	+9.4	+14.9	+0.5	-10.0	+9.6	+5.0	-4.2	+9.8	+7.7	+1.1
Other overseas sterling countries											
	+0.8	+2.0	+0.1	—	-0.4	+0.3	-0.7	+0.4	+2.5	-0.6	+7.8
Non-sterling countries											
	-0.1	+0.2	—	+0.2	+0.5	+0.4	+0.2	+0.2	+0.1	+0.1	-0.1
	+1.5	+11.6	+15.0	+0.7	-9.9	+10.3	+4.5	-3.6	+12.4	+7.2	+8.8
London market loans											
Overseas sterling countries (mainly Australia)											
	-1.5	+3.9	+30.0	+0.4	+2.4	+2.3	+9.9	+1.1	+3.7	+0.4	+12.1
Non-sterling countries (including international organisations)											
	+0.2	-17.8 ^c	-8.7 ^c	+0.3	—	+0.2	+0.2	+0.2	+0.2	-0.9 ^c	-17.2 ^c
	-1.3	-13.9	+21.3	+0.7	+2.4	+2.5	+10.1	+1.3	+3.9	-0.5	-5.1
Total	+0.2	-2.3	+36.3	+1.4	-7.5	+12.8	+14.6	-2.3	+16.3	+6.7	+3.7
of which:											
Government and municipal securities	+0.1	+5.6	+30.8	+1.6	+3.0	+4.3	+9.8	+1.0	+4.1	+2.8	+12.1
Company securities	+0.1	-7.9	+5.5	-0.2	-10.5	+8.5	+4.8	-3.3	+12.2	+3.9	-8.4

^a Including securities denominated in currencies of overseas sterling countries.

^b Financial institutions were asked in May 1966 by the then Chancellor of the Exchequer to exercise voluntary restraint over their portfolio investment in these countries. Individual investors were not subject to such restraint.

^c These figures include U.K. purchases of sterling/dollar convertible loans issued in the United Kingdom by American companies, which were offset in inward direct investment.

The figures show that there was net U.K. disinvestment in these securities in most quarters. Governments of overseas sterling countries have generally not borrowed afresh, during the period covered, when their London market loans have matured. There has also been considerable U.K. net disinvestment in the securities of South African companies, particularly in 1969 and again in the first half of this year. A feature of the third quarter of this year was the unusually large disinvestment in "other overseas sterling countries", which was virtually all in Hong Kong.

The enquiry shows moderate net purchases of Australian company securities in 1969 and the first quarter of 1970 and net sales since then. Official Australian estimates of U.K. portfolio investment in Australia, which were used in the compilation of the U.K. balance of payments up to the end of 1970, tended to show a somewhat greater net outflow to Australia, or a smaller net inflow from Australia, than the

portfolio enquiry. There were a number of reasons for this, mainly differences of coverage, classification and timing. The enquiry figures have been used since the beginning of 1971.¹

The new statistics obtained from this enquiry are a very valuable contribution towards improving our knowledge of the part that capital transactions play in the balance of payments, and the Bank wish to thank the contributors for their co-operation.

¹ These figures are combined with those of transactions in foreign currency securities to give the portfolio element of "U.K. private investment overseas" in Table 15 of the U.K. balance of payments article in the September 1971 issue of *Economic Trends*.