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IMF Committee on Balance of Payments Statistics
and Seventeenth Meeting of the Advisory Expert
Group on National Accounts

Inter-secretariat
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For discussion

D.16 Treatment of Retained Earnings: Outcome of Global Consultation

Prepared by the Direct Investments Task Team (DITT)

INTERNATIONAL MONETARY FUND

D.16 Treatment of Retained Earnings: Outcome of Global Consultation[1]

The global consultation supported that the Balance of Payments and International Investment Position Manual, sixth edition (BPM6) *paragraphs describing retained earnings should be revised as: "Retained earnings of an enterprise show the net earnings from current production and primary and secondary income transactions that have not been distributed". Also, most respondents agreed that the recognition of all the earnings generated down the direct investment (DI) ownership chain as primary income is the most conceptually sound option (Alternative A – status quo). Regarding compilation practices, (1) more than a third of respondents (19 respondents) agreed to the proposal of reporting indirect income separately; (2) more than half of the total respondents (26 respondents) agreed that a memorandum item showing the new obligatory provisions for bad loans in the reporting period would help data users interpret the statistics of reinvestment of earnings (RIE) for credit institutions; and (3) a vast majority (43 respondents) agreed that the RIE and Net Income should always be compiled regardless of the investment fund's attributes.*

In view of the broad agreement received during the global consultation, this Guidance Note (GN) is proposed to be considered by the Committee and the AEG for final decision.

OVERVIEW

1. **Fifty-one respondents from 49 economies participated in the global consultation of the Guidance Note (GN) D.16.**[2] The majority provided responses for balance of payments (27 respondents) followed by coordinated responses for balance of payments and national accounts (NA) (16 respondents), and for NA only (8 respondents). A majority indicated that the compilation approach for reinvestment of earnings (RIE) is consistent across balance of payments and NA (30 respondents). See Figure 1, Annex II. This consultation was scheduled from September 27 to October 25, 2021.

CONCEPTUAL ISSUES

2. **Most respondents agreed that the *Balance of Payments and International Investment Position Manual, sixth edition* (*BPM6*) paragraphs describing retained earnings should be revised as: "*Retained earnings of an enterprise show the net earnings from current production and primary and secondary income transactions that have not been distributed*" (46 respondents).** Several respondents indicated that the proposed definition brings more clarity.

3. **A large majority (37 respondents) agreed that the recognition of all the earnings generated down the DI ownership chain as primary income is the best option (Alternative A – status quo).** Several respondents also indicated that although, from a conceptual point of view, this is the best recommended alternative, from the practical point of view, this could present important challenges for its implementation. (See both conceptual findings in Figure 2, Annex II).

[1] Prepared by Ms. Rita Mesias (IMF) and Ms. Francesca Spinelli (OECD) of the DITT Secretariat.

[2] There were 23 responses from Europe, nine from the Asia and Pacific, seven from the Western Hemisphere, six from the Middle East and Asia, and four from Africa.

CURRENT COMPILATION PRACTICES[3]

4. About whether the presentation proposed in Alternative B[4] would be useful to enhance transparency and data comparability across countries, less than half the respondents (19 respondents) agreed to the proposal while the remaining respondents were divided between those who disagreed (15 respondents) and those, undecided (nine respondents). Many respondents also mentioned that despite the usefulness of this additional information, it would be difficult to collect (especially, for those that collect data on a consolidated basis) and could create additional burden to compilers. Also, a large majority of respondents supported clarifying either in the updated BPM or BPM Compilation Guide, the compilation of direct investment (DI) income. Examples in this regard are highly recommended.

5. More than half of the total of respondents (26 respondents)[5] agreed that a memorandum item showing the new obligatory provisions for bad loans in the reporting period would help data users interpret the statistics of RIE for credit institutions. Similarly, several respondents indicated that although this information could be useful, it will be difficult to collect, and, if adopted, statistical standards should provide detailed guidance for its collection.

6. A vast majority (43 respondents) agreed that the RIE and Net Income should always be compiled regardless of the investment fund's attributes. Around half of the respondents (24) supported the proposed treatment of operating expenses that are charged explicitly, with many respondents (16) undecided. The proposed treatment of operating expenses that are charged implicitly received support from less than half of the respondents, with even more (18) undecided. When consulted if their respective institutions can implement the guidance on explicit and implicit fees, 24 respondents in the case of explicit fees and 28 respondents in the case of implicit fees, indicated that they are not able to implement the proposed guidance.

7. The following additional suggestions were provided: (i) It would be important to treat portfolio investors the same way as direct investors in relation to earnings to ensure that the accrual principle is applied to all investors, (ii) new methodology/changes can be implemented but subject to data availability and readiness of respondents and compilers, and (iii) sufficient guidelines, clearer explanations, and practical examples/case studies should be provided in these areas.

[3] See practical findings in Figure 3, Annex II.

[4] That is, recognizing all the earnings generated down the DI ownership chain as primary income but reporting indirect income separately.

[5] The remaining half was divided between those who disagreed (12 respondents) and those who were undecided (11 respondents).

Annex I. WGIIS Consultation on GN D.16

WGIIS Consultation on GN D.16 *Treatment of Retained Earnings*

The OECD's *Benchmark Definition of Foreign Direct Investment, fourth edition* (*BD4*) provides detailed guidance on the compilation of direct investment (DI) statistics in line with the IMF's *Balance of Payments and International Investment Position Manual, sixth edition* (*BPM6*). The OECD's Working Group on International Investment Statistics (WGIIS) further contributes to the update of the international standards on DI (*BPM7* and *BD5*) by reviewing the guidance notes produced by the Direct Investment Task Team (DITT) and providing feedback at different stages.

During the public consultation phase, **the OECD WGIIS secretariat consulted with WGIIS delegates on the DITT GN D.16 to gauge their support and preferences.** Twenty countries responded to an online survey set up by the OECD. The OECD organized a webinar on October 14 to discuss the outcomes of the consultation and gather additional insights on the feasibility of the proposed approaches. There were more than 70 participants.

Issue 1. Calculation of Reinvestment of Earnings (RIE)

There was unanimous agreement from respondents to the questionnaire on the need to revise the *BPM6* paragraphs describing retained earnings and reinvested earnings. Most respondents prefer to clarify and address inconsistencies and to provide examples of RIE in the updated BPM Compilation Guide.

The majority of respondents (12) does not support the proposal of separating as memorandum item the obligatory provisions for bad loans when calculating RIE for credit institutions, mostly due to feasibility reasons. One respondent also stressed that information on provisions might also already be available in other datasets, such as financial stability data. During the webinar, various opinions were expressed regarding the need to reconsider the treatment of provisions in the updated guidelines, which would impact the measurement of Gross National Income (GNI). While it was acknowledged that the decision to revise their treatment should not be limited by its impact on the GNI, it was also stressed that one result of the proposal to subtract increases in provisions would be that there would not be any financing of the direct investor of provisions recorded in the accounts. There was not sufficient argumentation in the GN to justify why provisions should be treated differently than any other operations of the direct investment enterprise (DIE) that is financed by the direct investor nor to explain how the recording would work when the DIE had losses or when provisions decreased rather than increased.

Issue 2. Classification of RIE Along the Ownership Chain

Various challenges were raised by respondents, including those who indicated that they currently cover RIE from indirectly held affiliates in their Foreign Direct Investment (FDI) income statistics. Those challenges include data availability; difficulties to verify data and to communicate with respondents; reporting burdens for multiple affiliates; and difficulties measuring non-current operating performance concept (COPC) items from indirectly held affiliates.

A small majority of respondents (11) was in favour of maintaining the current guidance to classify RIE along the chain of ownership (Alternatives A or B), mostly to keep consistency with existing data and because it is the most theoretically sound recommendation. Of those, only three respondents were in favour of reporting indirect income separately, as an “of which” item (Alternative B). Eight respondents supported limiting the imputations of RIE to the profit and loss account of the immediate DIE (Alternative C), for practical reasons. It was stressed that while Alternative C could address practical challenges encountered by some countries, it would instead create challenges for those who already apply the current methodology, particularly those relying on consolidated records. **During the webinar, it was acknowledged that there are diverging opinions on this issue which will also likely emerge from the IMF global consultation and will require careful analysis from the Committee and the AEG.** The United States reported on the significant impact that the adoption of Alternative C would have on the US current account deficit. It also stressed that a large share of outward FDI is allocated to non-resident special purpose entities (SPEs) on an immediate basis so RIE credits would be largely under-evaluated if Alternative C were to be adopted. Complying with the current guidance is indeed challenging but it is preferable to maintain guidelines that are methodologically sound rather than ones that would be more practical but less correct conceptually.

Issue 3. Investment Income Attributable to Investment Fund (IF) Shareholders – Retained Earnings

Most respondents (15) agreed with the recommendation that RIE and net income of investment funds should be compiled regardless of the fund’s attributes. However, similar practical concerns were raised as well during the discussion of the guidance note on Collective Investment Institutions (GN D.3) (i.e., mostly difficulties in identifying IFs and to compile RIE of private equity funds).

There were dissenting opinions on the proposal to differentiate the treatment of fees that are charged implicitly or explicitly. Many respondents, including some who agreed with the proposal, raised feasibility concerns, such as increased reporting burdens or the lack of information from existing sources. It was also suggested to illustrate in the note the impact that such differentiated treatment would have on non-EU countries. During the webinar, Luxembourg suggested that the experience of economies with a significant population of investment funds should be considered when finalising the note.

Table 1 below reports the distribution of the answers received to the questions included in the online survey filled in by WGIIS delegates.

Table 1. Results of the WGIIS Consultation

	Yes	No
Q1. Do you agree that *BPM6* paragraphs describing retained earnings and reinvested earnings should be revised to reflect the discussion in paragraphs 15 and 16 of the GN?	20	0

Q2. Do you consider it relevant to clarify and address either in the updated BPM or the CG some inconsistencies/shortcomings in the current treatment and compilation of DI income, and to include examples of calculation of RIE?	
Alternative A1 Yes, in the BPM manual	6
Alternative A2 Yes, in the BPM compilation guide	13
Alternative A3 No further clarification needed	0

	Yes	No
Q3. Do you agree to separate as a memorandum item the obligatory provisions for bad loans when calculating the RIE for credit institutions?	4	12
Q4. Do you currently cover RIE from indirectly held affiliates in your FDI income statistics?	10	7

Q5. The GN proposes three possible alternatives for the treatment and collection of RIE along the chain of ownership. Please indicate what would be your preferred treatment(s). *Two respondents had no strong opinion between the three alternatives and are not counted in the results. 1 respondent selected both options A and B, therefore a total of 11 respondents were in favour or maintaining the current guidance (A and B).*	
Alternative A: Maintain the current guidance	9
Alternative B: Maintain the current guidance but report indirect income as an ‘of which’ item	3
Alternative C: Change current guidance to limit the imputation of RIE to the immediate DIE	8

	Yes	No
Q8. Do you agree that RIE and net income of investment funds (IF) should be compiled regardless of the fund’s attributes?	15	1
Q9. The GN discusses the current treatment of investment income attributable to IF’s shareholders […]. The GN proposes to apply a different treatment of operating expenses distinguishing between when they are charged implicitly or explicitly. Do you agree with this proposed treatment?	8	10

Annex II. List of Figures from the IMF Consultation

Figure 1. Introduction

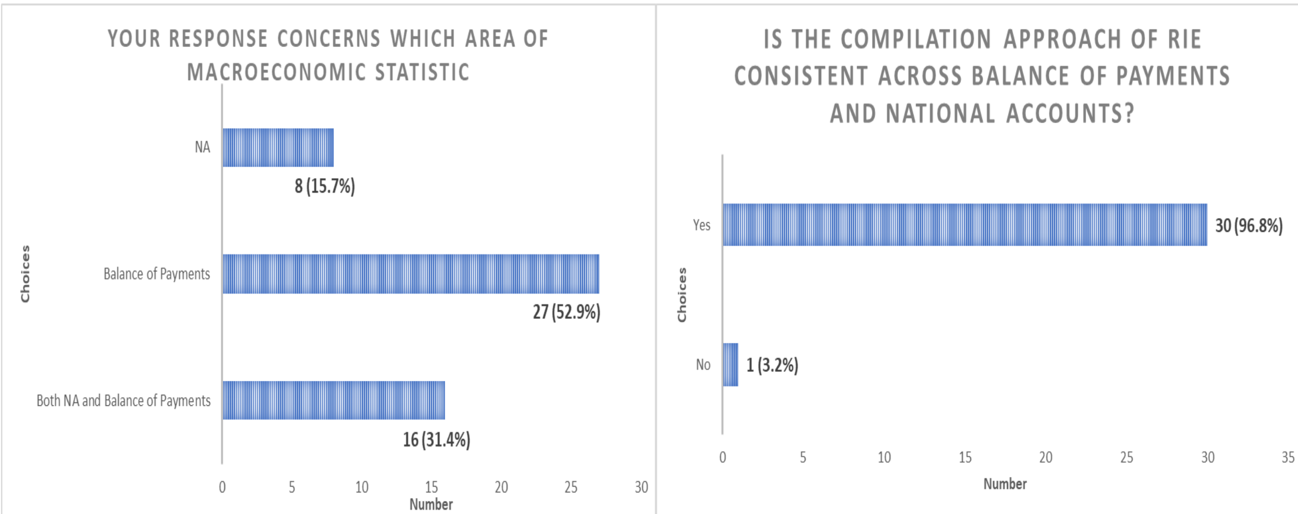


Figure 2. Conceptual Issues

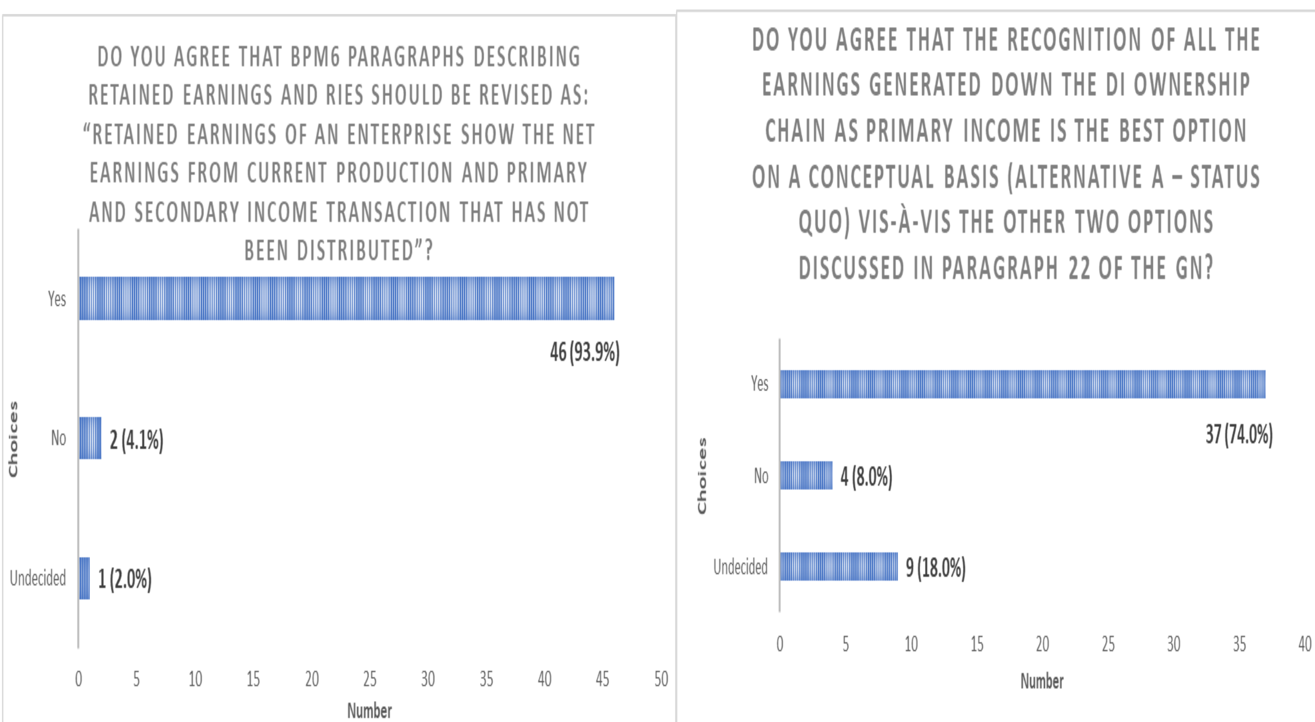
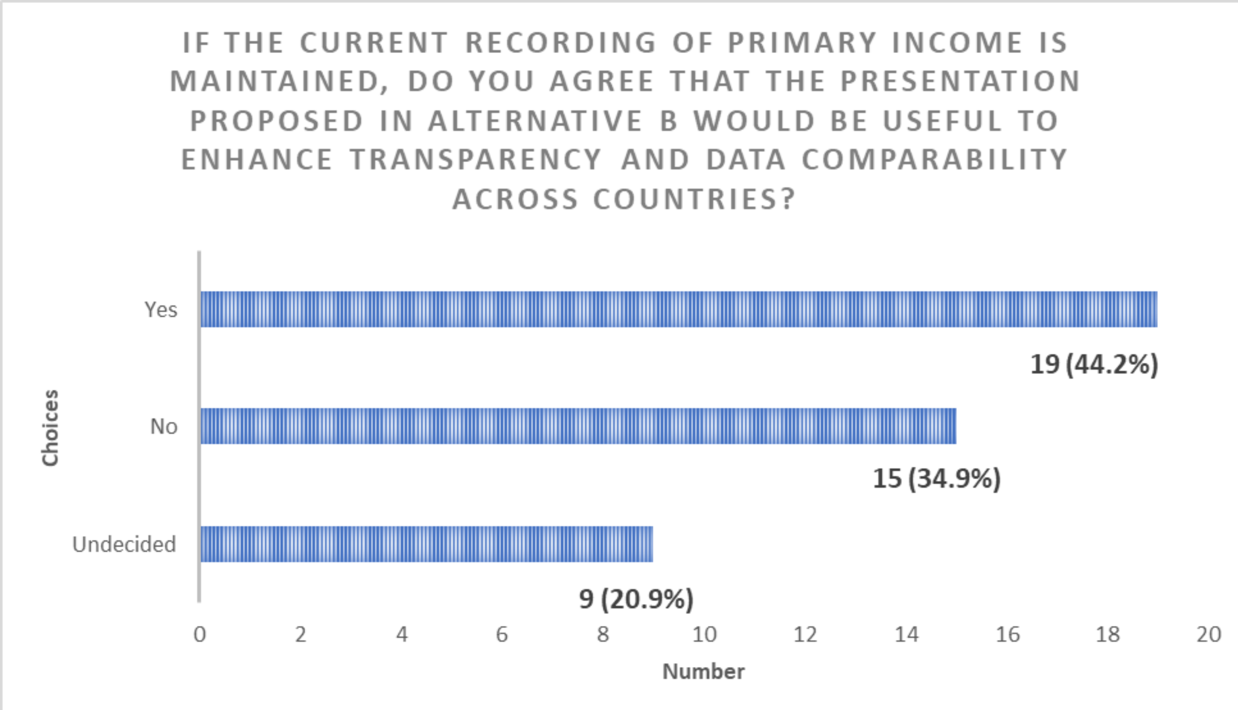
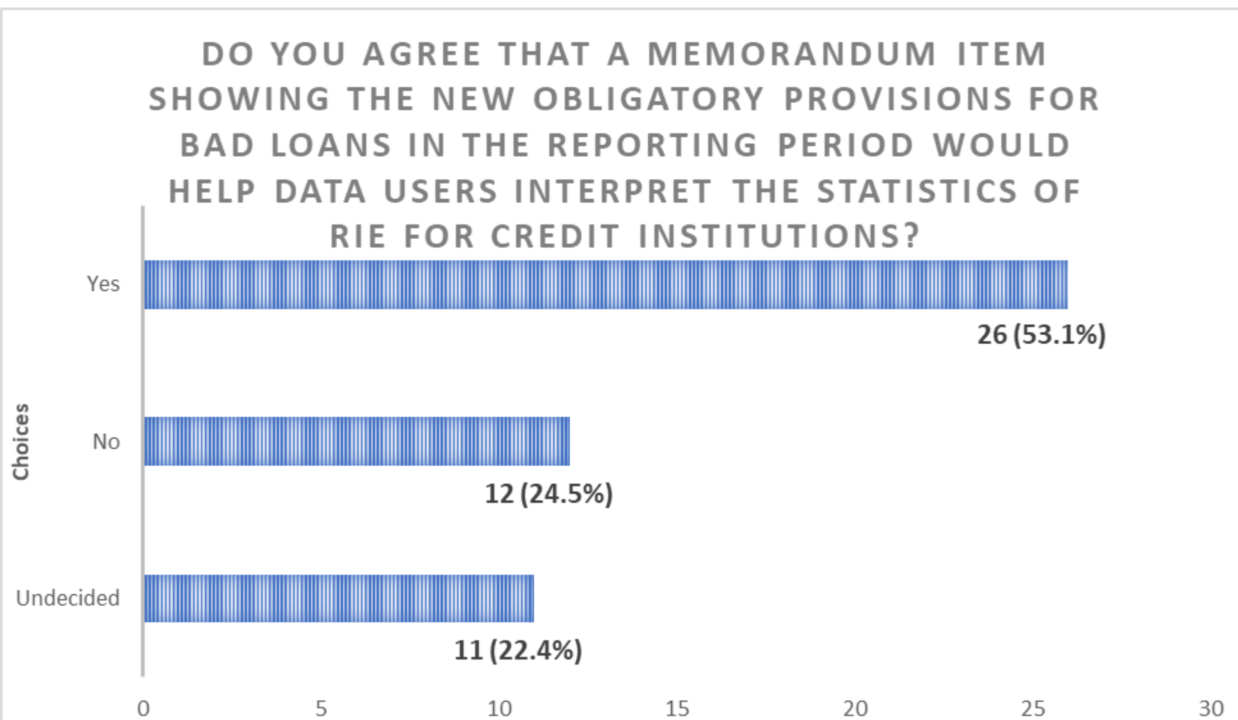


Figure 3. Practical Issues





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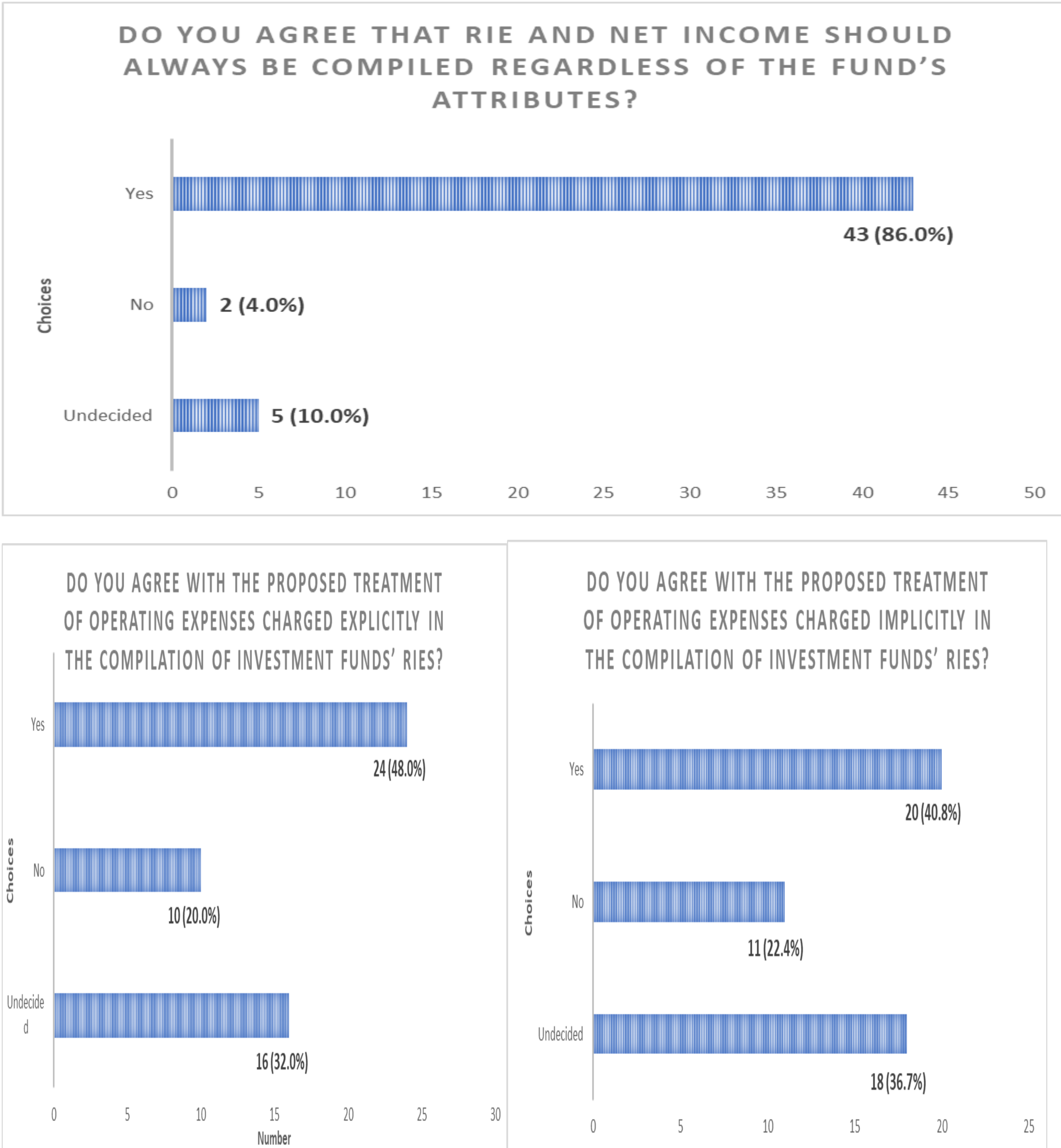

Figure 3. Practical Issues