



STATISTICS

INTER SECRETARIAT
WORKING GROUP ON
NATIONAL ACCOUNTS

D.16 Treatment of Retained Earnings (BOPCOM 22/09)/(SNA/M4.22/19)

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Outline

- Background
- Discussion of Issue
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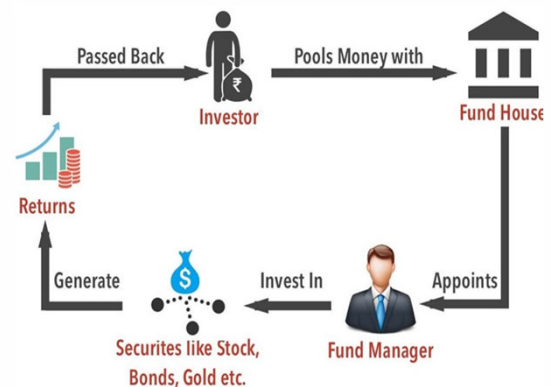
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Background

Investment funds (IFs) are collective investment schemes that raise funds by issuing shares or units to the public that become shareholders (BPM6 4.74).

- IFs legally and economically own the financial assets in which the funds raised are invested.
- IFs as institutional units should not be confused with firms that provide financial asset management services.
- IFs do not generally have direct employees but rather engage the services of administrators, trustees and/or portfolio managers to manage the operations of the funds.
- Fund managers only manage the activities of the fund, without taking ownership of their assets or assuming their liabilities—and are separate institutional units from the IFs.

The sequence of flows and the functions of the fund and the manager



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Background - Fee Structure of Investment Funds

Type of Fees	Description	Charges involved	Operating Expense of the IF?
Direct Fees*	Specific charges paid directly by the shareholder to the fund manager or other service provider.	Service e.g., from fund manager to shareholder. These may include some brokerage commission	No These fees do not involve the accounts of the investment fund and do not have an impact in the RIE calculation.
Indirect Fees*	Expenses paid by the IF to the third parties out of the investment income generated or out of the assets of the fund.	Charge e.g., from the fund manager to the IF Charge from the IF to the shareholder	Yes Treatment to be decided.

- Since there are no employees, IFs pay fees to service providers to support the fund's operations.
- The IF in turn charges a service fee to investors, equivalent to the operating expenses.
- There are two types of fees: (i) **recurring fees, based as a percentage of the shareholders assets** (Management Expense Ratio); (ii) **non-recurring fees** which are specific fees charged to a shareholder for early redemption, etc.

Discussion of the Issue

Treatment of Operating Expenses (and RIE) from Investment Funds

Issue

According to *BPM6* (para 11.38) undistributed earnings of investment funds are imputed as payable to the owners and then reinvested into the fund. This is applicable to both DI and portfolio investment. The consequence of this treatment, consistent with that of the *2008 SNA* on retained earnings of investment funds is that net savings of investment funds is always zero. **The net earnings of investment funds (investment income less operating expenses) ultimately belong to their shareholders and are either distributed via dividends or reinvested into the fund.**

BPM6 (10.124–10.125) notes that “...the shareholders’ income from investment funds is defined as the investment income earned on the fund’s investment portfolio after deduction of operating expenses.” However, no specific guidance is given on what should be considered operating expenses when calculating the investment fund’s RIE. Specifically, it seems unclear whether operating expenses charged implicitly or indirectly from the fund to the investor should be similarly included as well as the payment of taxes, or how to exclude/include service charges paid directly by the investor to the fund manager.

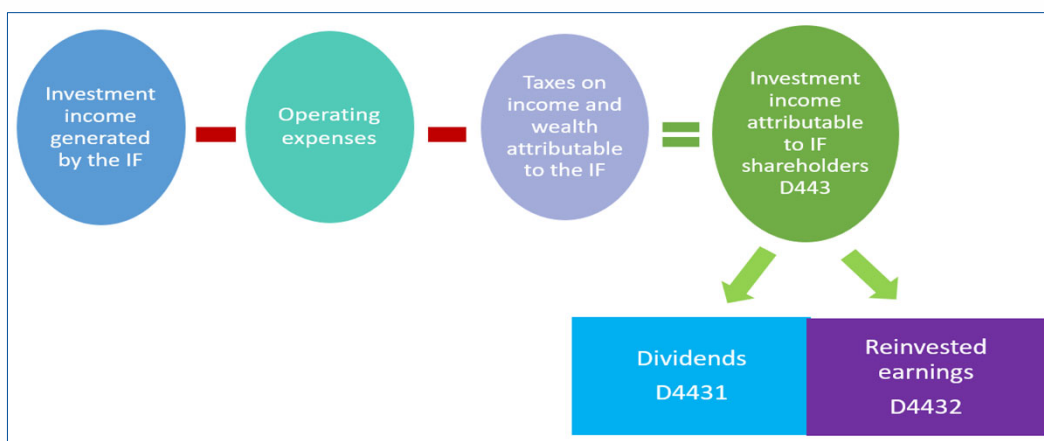
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Retained Earnings of Investment Funds

The income attributable to shareholders is calculated, then the retained earnings is defined as the **residual portion that is not distributed in the form of dividends to the collective investment fund shareholders.**



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What is considered an operating expense

Operating expense is the sum of all costs incurred in the normal course of business. It consists of all expenses (inputs) required to produce the output of the institutional units. For investment funds, the operating expenses include:

- the investment management charges that cover the costs of hiring and retaining investment advisors that manage the funds' investment portfolios;
- the costs of executing investors' sales and purchases, maintaining accounts, etc.;
- administrative costs related to marketing and distribution fees (which cover the costs faced by the fund for advertising, printing and distributing materials to investors and prospective investors), legal and accounting fees to prepare financial records as well as a number of other expenses such as custodian, central administration, distribution and audit fees.

The GN proposes three options to clarify the treatment of operating expenses in macroeconomic statistics.

Proposed Treatments

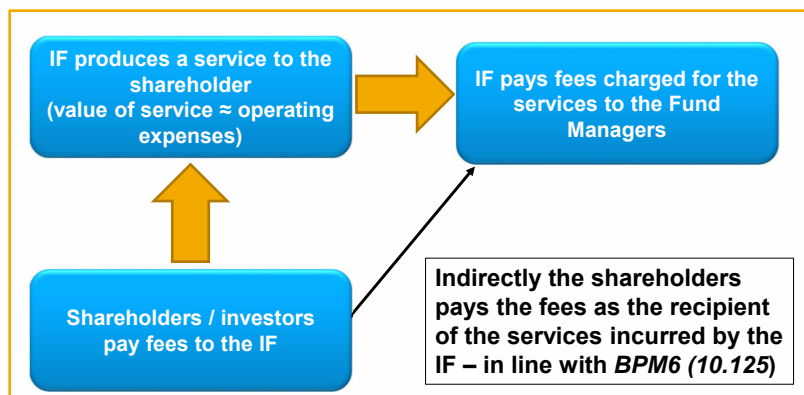
Proposal 1: Gross Approach – Investment Income

Charges are recorded as services provided by the providers to the IF, and then from the IF to the investor. However as there is no cash payment between the investor and the Fund, this treatment requires additional imputations to prevent a discrepancy between investment funds generated and those disbursed.

Example 1

Assume that an IF generates 15 units of income. The IF incurs 5 in operating expenses. The resulting 10 units may be invested in another instrument or kept as a deposit. The IF has not distributed any dividend to investors.

Gross Approach – Fees Indirectly Charged by the Investment Fund to Shareholders



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Treatment of the Operating Expenses/Inv. Income (SNA)

- Output & IC of 5 is estimated for the investment funds – GVA = 0.
- The Fund Manager generated 5 in output.
- The gross investment income (15) generated by the IF is attributable to the shareholder – imputed Dividends of 5 paid to the shareholders and 10 for RIE.
- Household Final Consumption Expenditure (HFCE) of 5 is recorded for shareholders.

Proposed Treatment – Net Approach

Proposal 2: Net Approach (Investment Income)

Service would not be imputed from the IF to the shareholders, and the income attributable to the shareholders would be calculated as the investment income generated by the investment fund minus the operating expenses.

This approach is in line with BPM6 11.38 but will result in a negative value added for the investment fund.

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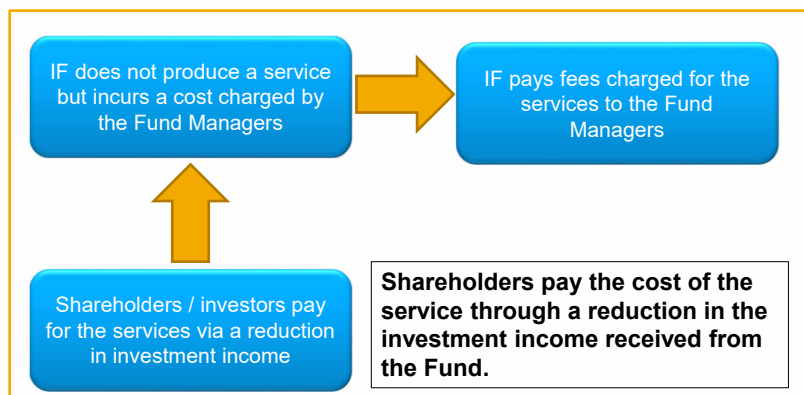
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Example 2

Assume that an IF generates 15 units of income. The IF incurs 5 in operating expenses. The resulting 10 units may be invested in another instrument or kept as a deposit. The IF has not distributed any dividend to investors.

Net Approach – Fees Indirectly Charged by the Investment Fund to Shareholders



Treatment of the Operating Expenses (SNA)

- **Output** of IF is (0) & IC is (5). Therefore GVA = -5.
- The **Fund Manager generated 5 in output**.
- The net investment income generated by the IF (**15 - 5**) is attributable to the shareholder as **RIE**.
- **No HFCE** is recorded for shareholders.

Proposed Treatment – Bypassing (Looking Through) the Investment Fund

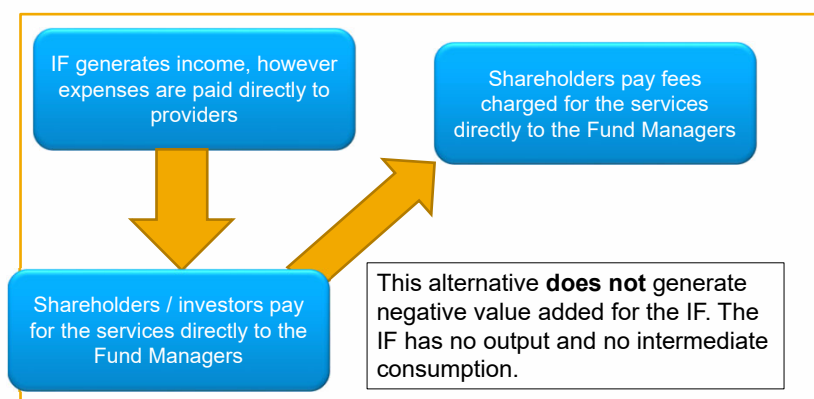
Proposal 3: Pass-through Approach

The service provided by the service providers would be directly imputed by the Fund Managers to the investors—bypassing the investment fund.

Example 3

Assume that an IF generates 15 units of income. The IF incurs 5 in operating expenses. The resulting 10 units may be invested in another instrument or kept as a deposit. The IF has not distributed any dividend to investors.

Net Approach – Fees Indirectly Charged by the Investment Fund to Shareholders



Treatment of the Operating Expenses (SNA)

- Output & IC & GVA is (0).
- Output of Fund Manager (5).
- The full investment income generated by the IF (15) is attributable to the shareholder as **imputed dividend (5)** and **RIE (10)**.
- **HFCE of 5** is recorded for shareholders **paid to the Fund Managers**.

Outcomes

- The recording of the indirect fees charged by the IF (in relation to how the operating expenses are allocated to the shareholders) lacks clarity in the standards.
- The calculation of income attributable to the shareholders in gross terms (i.e., not deducting operating costs), would require either the redefinition of RIE or the inclusion of a new imputed income component.
- Depending on the decided option on how to treat the operating expenses, the updated manuals should:
 - Clearly state that the IF is a separate institutional unit from the fund manager
 - Define the output of the investment fund and imputed transactions in the SNA.
 - Include a clear definition of operating expenses (and revenues) regarding CIS: *“Operating expenses of an investment fund should be defined as those costs necessarily incurred by the fund in its day-to-day operation”*
 - Note that the operating costs of an IF will be recorded when those costs are indirectly charged by the IF to the shareholder.
 - Clarify that “direct fees” are not operating expenses/revenues of the Fund and are not included in the calculation of RIE.

Questions for Discussion

- Do you agree that “direct fees” paid by the shareholders to third parties (e.g., Fund manager) are not operating expenses/revenues of the Fund and are not included in the calculation of RIE?
- Which of the 3 proposals to record the indirect fees charged to the shareholder by the investment fund would you support for the compilation of RIE by Funds?
- In case of supporting proposal 1 or 3, do you agree with the proposal to create a new income component—i.e., impute a “dividend” in the primary income account to show the amounts going to shareholders which will then be used to pay the service provided by the Fund (1) or by the third party (3)—or would you prefer to change the definition of RIE to cover the same amounts?

Thank You