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REINVESTED EARNINGS OF INVESTMENT FUNDS IN THE AUSTRALIAN NATIONAL ACCOUNTS

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INTRODUCTION

1. The revised international standards (2008SNA and BPM6) expand the imputation of reinvested earnings (RE) from undistributed foreign direct investment income (where direct investors are judged to have control of the corporation and can therefore influence distribution decisions) to include undistributed earnings in both resident and non-resident investment funds on the grounds that investors are able to withdraw and reinvest the equity in the investment funds. Under the revised standards, these earnings are attributed to the investors as an imputed dividend payment and imputed purchase of equity (reinvestment). This treatment adds (or subtracts) to the fund's equity and its liabilities to the unit holders, leaves the investment fund with no saving and increases the saving of the investor.

2. Reinvested earnings as prescribed by the SNA are defined as distributable income (net of capital gains/losses) less distributions. Distributable income comprises normal entrepreneurial income (dividends, interest and rents received) and excludes capital gains. In some periods reinvested earnings may be negative if the fund is paying distributions in excess of its distributable income. This is considered a withdrawal of equity.

3. In order to measure reinvested earnings for investment funds, the ABS started by defining investment funds within the Australian context which in turn provided a scope boundary for the reinvested earnings treatment. The availability of data for the defined scope determined the practicality of the recommendation.

CONCEPTS

Definitions

4. The 2008SNA revised subsectoring of the financial corporations sector as implemented by Australia is reflected in the Australian sector classification, *Standard Institutional Sector Classification of Australia (SISCA 2008).* The SISCA 2008 and the institutional sector classification as described in 2008SNA are broadly comparable.

5. One of the key changes introduced under the 2008SNA institutional sector classification was the separate identification of money market funds and other investment funds within the financial corporations sector. The ABS found the 2008SNA definition of investment funds fairly broad and therefore undertook considerable discussion and consultation internally and with major users to refine the definitional and classification aspects of such funds given their importance in the Australian economy. The ABS subsequently adopted a definition to suit the Australian context. However, the ABS acknowledges that the 2008SNA definition was designed to apply to different institutional and legal settings in operation in different countries and therefore the definition was necessarily broad.

6. The ABS defines investment funds as institutions which exhibit the following characteristics:

- Pooling of investors' monies to purchase assets;
- Assets are owned by a legal entity such as a trust or company, which issues shares/units to investors on a proportional ownership basis;
- The fund/company must be open to the public, either via a prospectus or a distribution channel (e.g. a platform); and
- The investors are able to dispose of their units and/or shares within a reasonable period of time, on a well-developed secondary market, such as a stock exchange or through readily accessible redemption facilities offered in association with the fund.

7. Investment funds displaying the above characteristics are classified to one of three categories in ABS national accounts statistics, as being money-market financial investment funds, non-money market financial investment funds, or non-financial investment funds. In Australia, only those investment funds investing predominantly in financial assets are treated as financial corporations. Those investing in non-financial assets, such as property, are treated as non-financial corporations. This is a minor departure from the 2008SNA which recommends that investment funds which invest in real estate (REIT's) should be classified to financial corporations. The ABS has deemed that a unit which derives the majority of its income through property rentals should not be classified to financial corporations but instead should be classified as a non-financial corporation. An advantage of distinguishing money-market financial funds separately is that it permits an alternative consolidation of money market financial funds with the broad money institutions sector for monetary analysis.

8. Several institutions that pool investor funds are not classified as investment funds because they are either not open to the public (e.g. property syndicates) or do not have a sufficiently active secondary market for their units and/or shares (e.g. agricultural, film and timeshare trusts and venture capital development funds).

9. The ABS believes that the ability to liquidate investment fund units/shares readily is a crucial conceptual justification for treating the undistributed earnings of these funds as if they are distributed and reinvested. An investor who holds units/shares in a fund with these facilities has a choice as to whether to maintain the investment into the next period, or withdraw the funds. If the investor chooses to maintain the investment, then it is appropriate to recognise that a reinvested earnings flow has taken place.

Difficulties in application of the concepts

10. Funds management activity can be broadly defined as the technique of aggregating small amounts of savings into cost-effective wholesale management pools. When the ABS first incorporated funds management activity into the financial accounts in the early 1990s, majority of funds being managed were from superannuation (pension funds) sources, and the major type of intermediary was the “pooled superannuation trust”. No change of ownership was recorded in the financial accounts due to the funds management activity as the majority of the pooled funds were from pension funds. Since then the methods of aggregation have developed. The “pooled superannuation trust” method of aggregation has evolved into multi-client master (wholesale) trusts. The wholesale pooled superannuation trusts are still significant in the Australian market. However, at the retail end of the market, the development of platforms and wraps has widened access to wholesale markets by individuals and small corporations usually using financial planners to enable access. The net result is that funds managers cannot classify their wholesale investment pools by type of retail investor. Discussion of these developments with users and internally resulted in the following:

a. Pooled superannuation trusts continue to perform a specialised pooling service for one class of investor only, pension funds. They are regulated by the Australian Prudential Regulatory Authority, thus ensuring their focus on superannuation and therefore the ABS has continued to classify pooled superannuation trusts to the pension fund subsector. This results in balances and flows between pooled superannuation trusts and their client superannuation funds being consolidated, and therefore no effective change of ownership being shown in the statistics produced by ABS;

b. Platforms and wraps are internet sales tools operated by financial services firms, and can be conceptualised as investment product menus. As such they are not intermediaries (involving a change of ownership), but provide services auxiliary to financial intermediation that may result in a change of ownership depending on the product selected. The ABS classified platform and wrap specialist operators as financial auxiliaries;

c. Wholesale (master) trusts and other non-specialist wholesale pooling arrangements that invest on behalf of a range of clients meet the criteria for being an institutional unit such that the funds pooled involve a change of ownership. At first the ABS had some difficulty applying the 'open to the public' criteria to the case of wholesale trusts. In Australia, wholesale trusts exhibit most of the characteristics of an investment fund but due to the fact they invest in wholesale amounts, they are technically not considered open to ordinary investors according to criteria laid out by the industry regulator. However, the extensive use of platforms as distribution channels by financial planners have provided investors with a menu of investment options, many of which provide the ability to invest directly into wholesale trusts. Through the use of platforms, the ABS deemed that wholesale trusts satisfy the 'open to the public' criterion and should be classified as investment funds. ABS has classified wholesale trusts to the non-money market financial investment fund subsector. There were significant impacts from this treatment, as a substantial amount of investment funds were previously looked through and therefore classified as a range of financial asset types and counterparty subsectors, with beneficial ownership for example by pension funds. This is now replaced by a single asset, equity and the counterparty subsector of non-money market financial investment fund.

METHODOLOGY

11. The methodology as prescribed by the 2008SNA for calculating reinvested earnings is:

Reinvested Earnings = Distributable Income (net of capital gains/losses) – Distributions

12. The following reported income and expense data from surveys and annual reports are used by the ABS to derive reinvested earnings as prescribed by the SNA:

- Total Income - Expenses = Operating income (includes capital gains and losses)
- Distributable Income = Operating Income - Capital gains and losses
- Dividends

Domestic

13. Reinvested earnings on domestic investment funds are calculated in the ABS national accounts statistics for non-financial investment funds, money-market financial investment funds and non-money market financial investment funds. Appendix 1 contains a detailed definition of these funds from SISCA 2008. Income and expenditure data from retail trusts, cash management trusts, common funds, listed investment companies and wholesale trusts are used to estimate reinvested earnings for the specified investment fund types.

Non-Financial Investment Funds

14. These include:

- Infrastructure funds (i.e. special purpose trusts that own assets such as airports, pipelines)
- Listed and unlisted property trusts

15. The data required to derive reinvested earnings are obtained from the ABS Quarterly Survey of Financial Information (Non-Money Market Funds). A full set of income, expenditure and distributions data are available from March quarter 1988. Reinvested earnings are derived using the prescribed SNA methodology.

Money Market Financial Investment Funds

16. These include:

- Cash common funds
- Cash management trusts

17. An estimate of reinvested earnings is reported in the ABS Quarterly Survey of Financial Information (Money Market Financial Investment Funds). Data for cash management trusts are available from September quarter 1988. Data for cash common funds are available from September quarter 1988 until June 2009. From June 2009 the reinvested earnings estimates are reported with estimates for new applications. To separate out the reinvested earnings estimates a model based on past reported data was used.

Non-Money Market Financial Investment Funds

18. These include:

- Listed and unlisted equity trusts
- Unlisted mortgage trusts
- Listed investment companies (LIC)
- Wholesale (master) trusts
- Non-cash common funds
- Other trusts (diversified holdings)

19. The data for reinvested earnings estimates for all of the above funds excluding wholesale (master) trusts and LICs are obtained from the ABS Quarterly Survey of Financial Information (Non-Money Market Funds). A full set of income, expenditure and distributions data are available from March quarter 1988. Reinvested earnings are derived using the prescribed SNA methodology.

20. Reinvested earnings estimates for LICs are derived using quarterly market capitalisation data reported to Australian Stock Exchange and annual reports for the top 7 LICs. From the annual reports, average ratios of income, expense, dividend and capital gain/losses to total assets are calculated (June 2002 to June 2011). These ratios are multiplied by the stock exchange quarterly market capitalisation to obtain total LICs income and expense items required to create the reinvested earnings estimates based on the prescribed SNA methodology.

21. Reinvested earnings estimates for wholesale funds are estimated from the ABS Quarterly Survey of Financial Information (Investment Managers). The reported income series is available for these funds from the survey from September 1998. The expenditure series is approximated using ratios of expenditure of wholesale funds to total assets sourced from a private sector actuarial report. The ratios for wholesale trust are applied to total assets reported by the survey. Applying the assumption that there is 100% investor roll-over in wholesale investments funds and no distributions, all distributable income is assumed to be reinvested earnings.

Measurement Problems

22. There are concerns regarding the quality of the income and expenditure estimates from the ABS Quarterly Survey of Financial Information as these estimates are not thoroughly edited compared with the balance sheet estimates, due to income and expenditure estimates having a lower priority in the work program of the area that undertakes the survey. However, recently the ABS has allocated resources for the income and expenditure data to be edited and therefore it is hoped that higher quality source data for compiling estimates for reinvested earnings will be available in the future.

23. In the interim some editing adjustments have had to be made to reported data for total income and expense, dividends and capital gains/losses from the ABS Quarterly Survey of Financial Information. These adjustments include, editing for the plausibility of the data by looking at movements within the income and expenditure series for investment funds and removing outliers. For example, adjustments have been made to reported total income estimates to ensure the inclusion of capital gain and losses and some analysis of the dividends series to ensure that super dividends are not included (consistent with the SNA treatment). These interim measures have generated relatively stable source data for estimating reinvested earnings for investment funds.

24. There are instances of large negative reinvested earnings occurring in periods when distributions include proceeds from holding gains, as the calculation of investment fund earnings and derived reinvested earnings will not include proceeds from holding gains. As earnings accrue continuously, it is important to record the imputed distribution of retained earnings continuously; the size of the imputed reinvested earnings is influenced by the actual distribution pattern. Actual distributions occur infrequently, once or twice per year. For these reasons Australia thinks it is important that quarterly estimates of retained earnings and reinvestments are included in the Australian National Accounts.

International

25. There has been no impact on income flows related to direct foreign investment as a result of the revised treatment of earnings of investment funds in BPM6 and 2008SNA. Any reinvested earnings of direct investment by investment funds have been treated as direct investment under the new standards. However, there are a number of problems for portfolio investment which are discussed below.

26. For foreign liability flows the calculation of reinvested earnings seems fairly straightforward because it is simply a subset of the domestic investment fund estimates. To derive investment earnings on foreign liabilities, an indicator yield taken from a major Australian stock index was applied to existing levels reported in portfolio equity securities from the ABS Quarterly Survey of International Investment for relevant sectors. Reported income taken from dividends was subtracted from the derived earnings figure to give reinvested earnings. However, the ABS has experienced some classification issues with the data being reported. Currently all reported dividend income on portfolio investment is being classified as other portfolio investment and no estimates are being reported for investment fund shares and in turn all distributable income from investment funds are being classified as reinvested earnings. The ABS is confident that the total dividend data from portfolio investment is correct; the current data quality issue is

related to the classification between equity and investment fund shares. ABS will be working with some of the major investment funds to obtain the dividend data directly.

27. For foreign asset flows, there are some problems with identifying the investment funds' portion of funds under management reported by funds managers in the international investment survey. Forms testing revealed that providers were unable to differentiate income sourced from dividends and returns from capital gains, nor were they able to report earnings on their investments in addition to the dividends already reported. It was hoped that providers would at least be able to supply levels of investment in investment funds in order to derive a split between investment funds and other portfolio equity. From this split it would have been possible to apportion dividend income data and then derive investment earnings and reinvested earnings from these figures, however to date this has not occurred.

28. As most of the foreign assets portfolio equity is sourced from resident fund managers and pension funds, it was assumed that all of the portfolio equity held or managed by these institutions was in the form of units in foreign investment funds, as these sectors are most likely to utilise this form of investment. To derive investment earnings on foreign assets it was assumed that the bulk of this is in equity funds. The major indicator dividend yields reported on major contributing countries' stock indexes was applied to existing levels reported in portfolio equity securities for the relevant sectors. Reported income taken from dividends was subtracted from the derived earnings figure to give reinvested earnings.

29. A major problem with the methodology to measure the reinvested earnings on both foreign assets and liabilities is the derivation of investment earnings using global and Australian stock indexes may be under or over estimating earnings and therefore in turn under or over estimating the derived reinvested earnings estimates.

RESULTS

30. Prescribed SNA methodology mentioned above in paragraph 13-21 is used to calculate total reinvested earnings payable by each domestic investment fund sector. Working under the assumption that reinvested earning payable equals reinvested earnings receivable, the Australian National Account reinvested earnings model ensures market balance. Therefore:

Total reinvested earnings payable (by a type of investment fund) = reinvested earnings receivable by domestic sectors + reinvested earning receivable by rest of the world - reinvested earnings payable by rest of the world to the investment fund

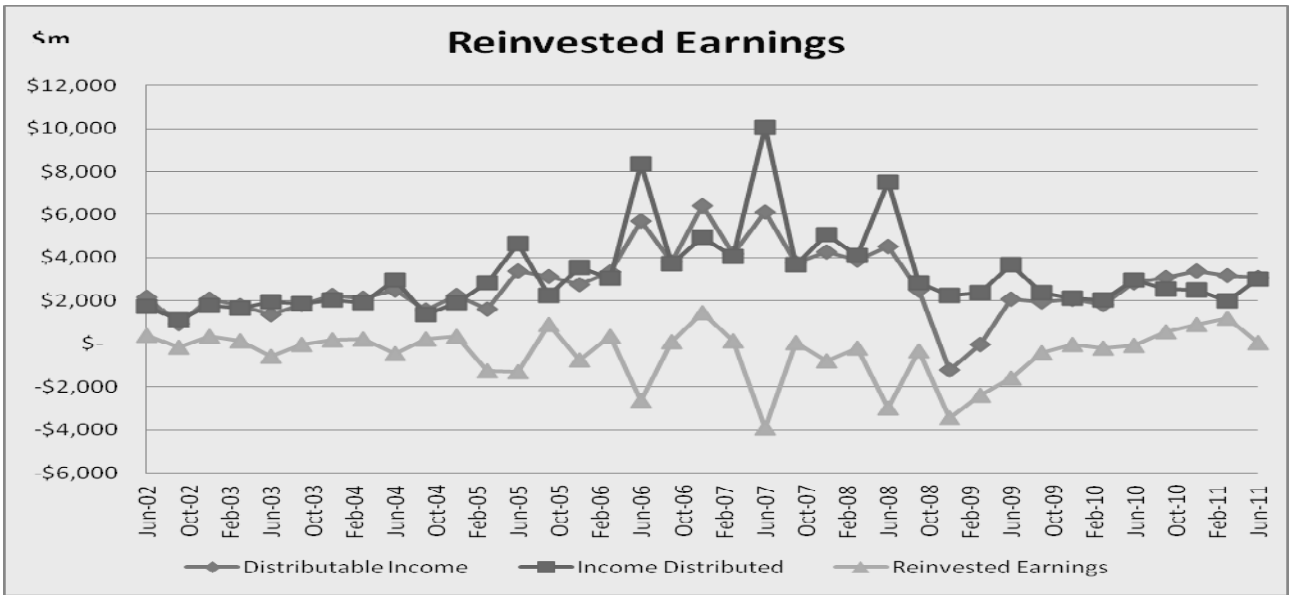
31. To generate reinvested earnings receivable from investment funds by domestic sectors, the reinvested earning payable by domestic non-financial investment funds and financial investment funds are used. The total reinvested earnings payable by domestic non-financial and financial investment funds minus their rest of the world payables plus their rest of the world receivables gives total domestic reinvested earnings receivable from investment funds following the earlier assumption that payables equals receivables.

32. The rest of the world payable and rest of the world receivable for non-financial and financial investment funds an assumption was drawn using equity holding ratios that non-financial investment funds held 40% of the total rest of the world reinvested earnings payables and receivable and that financial investment funds held 60% of the total rest of the world reinvested earnings payable and receivable. The methodology to generate total reinvested earnings on foreign assets (rest of the world payable) and liabilities (rest of the world receivable) is described above in paragraphs 26-29.

33. Allocation of domestic reinvested earnings (RE) receivable was distributed to sectors using quarterly sectoral asset holders of equity issued by the three categories of investment funds from the Australian National Accounts, Financial Accounts publication.

	Jun-11	*Jun-10*	Jun-09	*Jun-08*	*Jun-07*	Jun-06	*Jun-05*
Non-Financial Corporations $m Current price							
property income receivable - RE on Investment funds	161	-202	-408	-79	14	16	-5
property income payable - RE on Investment funds	3007	-4214	-6375	655	5917	2107	1390
Financial Corporations $m Current price							
property income receivable - RE on Investment funds	2176	1658	-5156	-3387	-2648	-2247	-1854
property income payable - RE on Investment funds	1	3574	-1370	-4577	-8122	-4289	-3328
Households $m Current Prices							
property income receivable - RE on Investment funds	422	168	-647	-437	156	-183	-231
Rest of the World							
property income receivable - RE on Investment funds	2174	1474	1909	1276	1385	812	731
property income payable - RE on Investment funds	1924	3738	3443	1294	1113	580	581

34. The expanded imputation of reinvested earnings has affected the estimates of sectoral saving in the national accounts. Saving for the financial corporation sector has fallen, as income flows are imputed to households and other holders of the investment funds. The counterpart to this flow saw an increased saving and net lending for the holding sectors, from the imputed reinvestment into the non-financial and financial corporation sector. The estimate of total reinvested earnings of Australian Investment Funds from June 2002 to June 2011 are presented below:



APPENDIX 1

1001 Non-financial investment funds (111)

Non-financial investment funds are collective investment schemes that are constituted as legal entities which raise funds by issuing shares or units to the public. The proceeds are invested predominantly in long-term non-financial assets. Investment fund shares or units are generally not close substitutes for deposits.

Investment funds exhibit the following characteristics:

- Constituted as legal entities such as trusts or corporations;
- Assets owned by the investment fund;
- Pooling of investors' monies to purchase non-financial assets (such as property or infrastructure);
- Issues its shares/units to investors;
- Investment decisions made by a licensed fund manager external to the fund;
- Open for public subscription, either via a prospectus or a distribution channel such as a platform;
- Investors are able to dispose of their units/shares within a reasonable period of time, on a well-developed secondary market, such as a stock exchange or readily accessible redemption facilities.

Includes

- Infrastructure funds (i.e. airports, pipelines)
- Listed and unlisted property trusts
- Property common funds

Exclusions/References

(a) Investment funds which predominantly invest in financial assets are included in the relevant classes within Group 214 Financial investment funds;

(b) Film funds are included in Class ;

(c) Non-financial investment funds which do not have a sufficiently active secondary market are included in Class 1009 Other non-financial corporations;

(d) Financial investment funds which do not have a sufficiently active secondary market are included in Class 2199 Other financial intermediaries;

(e) Financial investment syndicates which are not open to public subscription are included in Class 2309 Money lenders and other captive financial institutions;

(f) Non-financial investment syndicates which are not open to public subscription are included in Class 1009 Other non-financial corporations;

(g) Primary production funds are included in Class 1009 Other non-financial corporations;

(h) Time-sharing funds holding predominantly financial assets are included in Class 2199 Other financial intermediaries; and

(i) Trusts with predominantly overseas property or infrastructure holdings are included in Class 2142 Non-MMF financial investment funds.

2141 – Money market investment funds (241)

Money Market Funds (MMFs) are collective investment schemes, constituted as legal entities that raise funds by issuing shares or units to the public. The proceeds are invested primarily in money market instruments, MMF shares/units, and transferable debt instruments with a residual maturity of less than one year, bank deposits and instruments that pursue a rate of return that approaches the interest rates of money market instruments. MMF shares can be transferred by cheque or other means of direct third-party payment. Because of the nature of the instruments the schemes invest in, their shares or units may be regarded as a close substitute for deposits.

Includes

- Cash common funds
- Cash management trusts

Exclusions/References

(a) Cash management accounts are included in Class 2141 Money market funds (MMFs).

2142 – Non-Money market investment funds (242)

Non-MMF investment funds are collective investment schemes that are constituted as legal entities which raise funds by issuing shares or units to the public. The proceeds are invested predominantly in long-term financial assets. Investment fund shares or units are generally not close substitutes for deposits.

Financial investment funds exhibit the following characteristics:

- Constituted as legal entities such as trusts or corporations;
- Pooling of investors' monies to purchase financial assets;
- Assets owned by the investment fund;
- Issues its shares/units to investors;
- Investment decisions made by a licensed fund manager external to the fund;
- Open for public subscription, either via a prospectus or a distribution channel such as a platform;
- Investors are able to dispose of their units/shares within a reasonable period of time, on a well developed secondary market, such as a stock exchange or readily accessible redemption facilities.

Includes

- Listed and unlisted equity trusts (domestic and international)
- Listed and unlisted mortgage trusts (unit trusts)
- Listed infrastructure trusts
- Listed investment companies
- Master trusts
- Non-cash common funds
- Trusts with predominantly overseas property or infrastructure holdings

Exclusions/References

(a) Investment funds which predominantly invest in non-financial assets are included in Class 1001 Non-financial investment funds;

(b) Financial investment syndicates which are not open to public subscription are included in Class 2309 Money lenders and other captive financial institutions;

(c) Non-financial investment syndicates which are not open to public subscription are included in Class 1009 Other non-financial corporations;

(d) Non-financial investment funds which do not have a sufficiently active secondary market are included in Class 1009 Other non-financial corporations;

(e) Financial investment funds which do not have a sufficiently active secondary market are included in Class 2199 Other financial intermediaries; and

(f) Pooled superannuation trusts are included in Class 2131 Pension Funds.