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For discussion

Treatment of Participations in the Capital of International Organisations and the Respective Income

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In November 2016, the need for clearer guidance on the treatment of income on other equity related to international organisation (IOs) capital was included in the medium-term research agenda for the European Central Bank's Working Group on External Statistics (WG ES) ¹ The aim of this note is to propose the methodological treatment of participations in the capital of IOs ² and the recording of the respective income. Particularly, it proposes to classify the capital subscription to IOs, including in the form of unlisted shares, under other investment – other equity, and the related income to be classified under other investment income– withdrawals from income of quasi corporations.

1. The issue at stake

It is a fact that IOs can issue (unlisted³) shares and distribute the profits in the form of dividends, although in most of the cases the capital of IOs is not in the form of securities (shares). In this context, **should the participations in the capital of IOs and the respective income be reflected in different functional categories depending on the form of the capital?** Is this meaningful from a conceptual point of view or should all these participations be included under the same instruments and functional category as the purpose and characteristics of the investment are the same and are not linked to the legal form that capital may take?

The *BPM6* makes several references to the classification of capital subscriptions to IOs (see Annex). **Paragraph 6.32 mentions that equity in IOs is excluded from direct investment, even in cases in which voting power is 10 percent or more, so equity contributions are included in portfolio investment (if in the form of securities) or other investment - equity (if not in the form of securities).** Equity in IOs would not generally qualify as reserve assets, even if denominated in foreign currency because of the lack of liquidity (i.e., they are not readily available). Paragraphs 6.32 and also 6.106 clearly state that capital subscriptions to IOs are included under portfolio investment if they are in the form of securities.⁴

The *BPM6* in paragraph 5.26 mentions as an example that the equity in the Bank of International Settlements (BIS) is in the form of unlisted shares therefore following paragraphs 6.32 and 6.106 these equities should be classified in portfolio investment by its shareholders. Following this approach, although

¹ [Medium term research agenda for the WG ES.](#)

² International organisations are entities established by formal political agreements between their members that have the status of international treaties; their existence is recognised by law in their member countries; they are not treated as resident institutional units of the countries in which they are located (SNA 4.173).

³ It could be some exceptional cases of quasi- international organizations that are profit-oriented and whose capital may be even in the form of listed equities. See for example the African Export-Import Bank.

⁴ This introduced a change in the treatment of capital subscription to IOs from *BPM5* that included all of them under other investment / other assets and liabilities (see *BPM5* §422).

not explicitly mentioned in BPM6, the income (potentially) distributed by the BIS in the form of dividends should be consistently included under PI income – dividends.

2. Non-negotiability nature of the participations in IOs

The participation/subscription of a country in the capital of IOs follows geopolitical and institutional considerations, i.e., only selected countries can be members of a certain IO and the capital subscription is restricted to certain institutions, e.g., the central government or the central bank⁵. Due to the “political” nature of IOs, member’s capital subscriptions are determined based on economical and/or demographical indicators of the member countries and hence they are usually not readily available to the holder.

Transactions in the equity of IOs are mostly due to: (i) a re-assessment of the share of each country member by the IOs when new countries join or leave; (ii) a re-assessment every certain number of years (e.g., 5 in the case of the ECB) to adjust for the change of economical/demographical weights of the country members; and, (iii) increases in the paid-up contributions to support the activities of the IOs. None of these transactions are triggered or decided by individual country members (investors). Most probably the only decision (if any) that an individual country member may take is to request joining and/or leaving the IOs, and therefore this decision will be linked to the acquisition/redemption of its participation. In any case, those transactions will be conditional to defined criteria and will in most cases depend on the consent of the issuer (IOs).

As recommended by the international statistical standards, it indeed seems appropriate not to record subscriptions to the capital of IOs under direct investment even though these contributions may exceed 10 percent of the voting power of these institutions. Furthermore, bearing in mind that the capital subscriptions are based on geopolitical considerations (as described in the beginning of this section), namely that they are not legally and freely (unconditionally) tradable by member countries, it seems also not very appropriate to consider them under portfolio investment, even though they may have the form of (unlisted) securities. Similarly, if these equities are not liquid and readily available, they should also not be included under reserve assets, even if they are held by the monetary authority and denominated in foreign currency. **Therefore, all the capital subscriptions of IOs that are not tradable would conceptually be more appropriately reported under other investment without making any distinction based on the legal form of the IOs capital.**

This classification would better reflect the non-negotiable nature of the participations in IOs; however, according to the *BPM6* the classification of investments in “unlisted shares” is not foreseen in other investment. Consequently, taking into account the above-mentioned assessment, the WG ES have assessed two alternative classifications:

- i) Consider that from a statistical point of view all the capital subscriptions of IOs are classified as “**other equity (F519)**” to be recorded under other investment without making any distinction based on the legal form of the IOs capital. This would not change the *BPM6*

⁵ Those supranational institutions that are more profit oriented and whose capital is hold by other sectors than the central government, the central bank and other international institutions may have capital in the form of tradable equities would not fit in the proposal of this note.

standard presentation but would require a clarification/correction to *BPM6* (namely paragraph 6.32). The related income would also be recorded under other investment income “withdrawals from income of quasi-corporations (D420)”.

- ii) Change the *BPM6* standard presentation by including a new breakdown under Other investment to cover “**Unlisted shares of IOs (F512)**” and consistently, the related income should be included under other investment income: “Dividends and withdrawals from income of quasi-corporations (D42)”. This would be necessary to cover the dividends distributed by IOs whose capital is in form of unlisted shares (to the best of our knowledge currently only the BIS and the European Stability Mechanism (ESM)).

The WG ES as well as Committee members’ general support option i) as it better reflects the economical characteristics of the participations in the capital of IOs without providing them “too much” relevance in the *BPM6* standard presentation. On the contrary option ii) could be misleading for the users as it would suggest the classification of unlisted shares under other investment while the participations in IOs are a clear exception based on the legal and not on the economical form of IOs’ capital.

It is proposed that a clarification note to announce also a future amendment of *BPM6* to be published explaining that all the capital subscriptions in IOs that are not tradable should be reported based on their economical nature under “other investment – other equity” in spite of the legal form of the capital (i.e., unlisted shares or other equity). Consequently, all the related income should be reported under other investment - withdrawals from income of quasi-corporations. Furthermore, these treatments should be also updated in national accounts (SNA) to ensure consistency at methodological level.

3. The particular case of the BIS and ESM capital

In November 2017, the WG ES discussed the classification of several financial instruments issued by the BIS.⁶ It was agreed that although **the participations (paid-up) in the capital of the BIS are in the form of unlisted shares**, they should not be included in portfolio investment as the central banks participating in the BIS cannot buy and sell freely these shares.⁷ Considering *BPM6* (only paragraph 5.26) and the *Handbook on Securities Statistics* (paragraph 3.60-62), the statistical treatment recommended in the euro area is since to report the BIS equity under “other investment - other equity” for the amount already disbursed, excluding the subscribed, but not yet paid capital (recorded at book value).

A more recent example, very relevant in terms of volume (€80bn) for the euro area countries, was the paid-up capital subscriptions of the ESM. According to the treaty establishing the ESM (T/ESM 2012-LT),⁸ **the ESM capital is in the form of shares and its earnings will be distributed to the shareholders in**

⁶ [See Item 2.6 - Statistical recording of the BIS instruments](#)

⁷ [See the summary conclusions and actions list - WG ES meeting 8-9 November 2017 FINAL](#)

⁸ https://www.esm.europa.eu/sites/default/files/20150203_-_esm_treaty_-_en.pdf

the form of dividends. Following a recommendation of the ECB, the ESM paid-up capital is reported as other equity in other investment. As regards to income, so far, the ESM has not distributed dividends.⁹

For the reasons explained above, it is proposed to classify the BIS and ESM unlisted equities under other investment – other equity. This is in principle a deviation from the *BPM6* that recommends including them under portfolio investment because of the (legal) nature of the financial instrument. The classification under other investment of investments in unlisted shares issued by IOs should be applied not only to the BIS and ESM capital subscriptions, but consistently to all capital subscriptions of IOs issued in the form of unlisted shares.

Questions for the Committee:

1. *Does the Committee agree with the proposal to classify all capital subscriptions in IOs, including in form of unlisted shares, under other investment – other equity?*
2. *Consequently, does the Committee agree that the income on capital subscription to IOs be recorded under other investment income– withdrawals from income of quasi corporations?*
3. *Does the Committee agree that the concluding step would be to publish a clarification note that addresses the treatment of the non-tradeable capital subscriptions in IOs and would announce a future amendment of the *BPM6* and other relevant manuals/guides?*

⁹ See the agreed transmission of data vis-à-vis the ESM <https://darwin.escb.eu/livelink/livelink/overview/68451060>

Annex: BPM6 references

5.26 *Other equity is equity that is not in the form of securities.* It can include equity in quasi-corporations, such as branches, trusts, limited liability and other partnerships, unincorporated funds, and notional units for ownership of real estate and other natural resources. **The ownership of many international organizations is not in the form of shares and so is classified as other equity (although equity in the BIS is in the form of unlisted shares). Ownership of currency union central banks is included in other equity (see paragraph A3.44).**

6.32 Equity in international organizations is excluded from direct investment, even in cases in which voting power is 10 percent or more, so equity contributions are included in portfolio investment (if in the form of securities) or other investment—equity (if not in the form of securities). Equity in international organizations would not generally qualify as reserve assets because of the lack of ready availability (see paragraph 6.69).

6.62 Other equity is included in other investment, when it is not direct investment or reserve assets. Other equity, as defined in paragraph 5.26, is not in the form of securities, so it is not included in portfolio investment. Participation in some international organizations is not in the form of securities and so it is classified as other equity. In most cases, equity in quasi-corporations for branches and notional units for ownership of land is included in direct investment; however, it is included in other investment if the share of voting power is less than 10 percent.

6.106 Capital subscriptions to international organizations that are not readily available to the monetary authorities do not meet the definition of reserve assets. These subscriptions are included in other investment, unless they are in the form of securities, in which case they are classified as portfolio investment.

11.32 Dividends and withdrawals by owners of quasi-corporations are also identified for equity in investment funds. Investment funds are usually portfolio investment, but they may also occur in other functional categories. For equity in investment funds and direct investment, the owners' earnings include both the distributed income and reinvested earnings.

6.54 *Portfolio investment is defined as cross border transactions and positions involving debt or equity securities, other than those included in direct investment or reserve assets.* Securities are defined in paragraph 5.15. The negotiability of securities is a way of facilitating trading, allowing them to be held by different parties during their lives. Negotiability allows investors to diversify their portfolios and to withdraw their investment readily.

6.56 Portfolio investment covers, but is not limited to, securities traded on organized or other financial markets. Portfolio investment usually involves financial infrastructure, such as a suitable legal, regulatory, and settlement framework, along with market-making dealers, and a sufficient volume of buyers and sellers. However, acquisition of shares in hedge funds, private equity funds, and venture capital are examples of portfolio investment that occurs in less public and more lightly regulated markets. (However, shares in these funds are included in direct investment when the holdings reach the 10 percent threshold, and in other equity in other investment when investment is not in the form of a security and not included in direct investment or reserve assets.) Portfolio investment is distinctive because of the nature of the funds raised, the largely anonymous relationship between the issuers and holders, and the degree of trading liquidity in the instruments.

A3.48 Distribution of profits of the CUCB should be classified as income on the financial asset to which member economies' subscriptions are attributed.