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SM/84/84

April 23, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Treatment of Reserve Tranche - Attribution of Reduction in
Fund's Holdings of Currencies - Review

It is not proposed to bring the attached memorandum to the agenda of the Executive Board for discussion unless an Executive Director so requests by noon on Monday, April 30, 1984. In the absence of such a request, the draft decision appearing on page 7 will be deemed approved by the Executive Board and it will be so recorded in the minutes of the next meeting thereafter.

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INTERNATIONAL MONETARY FUND

Treatment of Reserve Tranche: Attribution of Reductions
in Fund's Holdings of Currencies - Review

Prepared by the Treasurer's Department

(In consultation with the Legal Department)

Approved by W.O. Habermeier

April 23, 1984

I. Introduction

In April 1981, the Executive Board decided (a) that a member did not need to use its reserve tranche position in the Fund prior to making purchases in the credit tranches or under extended arrangements, i.e., purchases under stand-by or extended arrangements are to be excluded under Article XXX(c) for the purpose of the definition of "reserve tranche"; and (b) a member that had outstanding purchases subject to repurchase would have the option, subject to certain qualifications, to attribute a reduction in the Fund's holdings of its currency resulting from a sale of its currency either to its reserve tranche position or to the discharge of outstanding obligations. The option to attribute reductions in holdings to the reserve tranche was extended in February 1982 to reductions resulting from operational payments by the Fund (e.g., payment of remuneration to a member in its own currency or the use of a lender's own currency by the Fund to repay borrowing or to pay interest on borrowing). ^{1/} The texts of these decisions are reproduced in Appendix 1 and 2.

The Fund needs to review these decisions before April 30, 1984, and this paper provides the occasion for such a review. Section II reviews the Fund's experience with the new treatment of the reserve tranche and Section III deals with attributions made by certain members of reductions of the Fund's holdings of their currencies. In the final section a decision is proposed for the adoption by the Executive Board which recommends that the existing decisions remain in effect without change.

^{1/} A decision was also taken to exclude balances held in the administrative accounts that are not in excess of 0.1 percent of a member's quota for the determination of the member's reserve tranche position. See SM/82/18 "Treatment of Reserve Tranche--Attribution in Fund's Holdings of Currencies", January 26, 1982. See also SM/81/71 "Treatment of Reserve Tranche", March 30, 1981.

II. Treatment of Reserve Tranche

The main purpose of the decision, from the point of view of members, was to improve the asset character of reserve tranche positions in the Fund by giving members additional flexibility as to the retention, use, and re-establishment of these positions. From the point of view of the Fund, it was expected that insofar as members purchasing in the credit tranches or under extended arrangements did not also use their reserve tranche positions (including the unremunerated portion), the Fund's liquidity and income positions were likely to benefit. Use of Fund credit and policies on early repurchases were not expected to be affected, and asset payments for quota increases would be facilitated in certain circumstances.

a. Experience

The experience so far is that a number of members have acquired, held and sometimes increased their reserve tranche positions in the Fund while using Fund resources under the credit tranches and under extended arrangements or have maintained their reserve tranche positions while reducing their indebtedness to the Fund. The facts are as follows.

At March 31, 1984, of the seventy-two members that had outstanding use of Fund credit in the tranches or under extended arrangements, thirty members held reserve tranche positions that were more than minimal (i.e., more than SDR 50,000). ^{1/} These reserve tranche positions totalled approximately SDR 1 billion, of which approximately SDR 0.5 billion was created or increased as a result of the reserve asset payments for quota increases under the Eighth Review. The distribution of holdings of reserve tranche positions was as follows: one member held close to SDR 500 million, three others in amounts ranging between SDR 70-90 million, and the rest in amounts of SDR 39 million or less.

In addition, during the 35 months since the decision was adopted on May 1, 1981 a total of sixty-six members had arrangements in effect for some part of the period. Of these members, twenty-one had reserve tranche positions at the beginning of an arrangement. Seven of them subsequently made full use of the positions while two others made partial use. The remaining twelve members either increased their reserve tranche positions or have not drawn against them. Moreover, sixteen other members acquired reserve tranche positions during the period of an arrangement, largely as a result of the reserve asset payments for the recent quota increases, and had not drawn them at March 31, 1984.

^{1/} The compensatory financing and buffer stock facilities could be used before the 1981 decision without prior use of a reserve tranche position; out of a total of 12 members making use only of these special facilities at March 31, 1984 10 members held reserve tranche positions.

As regards reductions of indebtedness to the Fund during the period May 1, 1981 to March 31, 1984, a total of forty-five members made repurchases on one or more occasions with SDRs or foreign exchange rather than use their reserve tranche positions, although those members that had a balance of payments need could have encashed their reserve tranche positions to finance these repurchases. About one half of these members did, however, use their reserve tranche positions in full at a later date; the other half either maintained their reserve tranche positions in the Fund throughout the period or used part of their reserve tranche positions and in some cases later increased these positions.

All of the above would seem to confirm that the flexibility accorded to members with regard to their reserve tranche positions in the Fund has been useful to them.

b. Implications for the Fund

Although the amount was not large, the Fund's liquidity benefitted to the extent that the Fund did not need to finance reserve tranche purchases prior to or concurrently with members' use of Fund credit. The income effect was also beneficial to the extent that the members concerned held unremunerated positions in the Fund (SDR 0.7 billion out of a total of SDR 6.3 billion at March 31, 1984). There is also no evidence that providing members with the discretion of using their reserve tranche has led to larger use of the credit tranches or the extended facility; the amounts available under arrangements were the result, inter alia, of access limits, adjustment measures undertaken or agreed, balance of payments and financing needs, and performance under arrangements. Finally, as regards the quota increases under the Eighth Review the required asset payments were considerably facilitated for those members that had purchases outstanding in the credit tranches or under extended arrangements. Without the present decision on the treatment of the reserve tranche, the asset payment for the increased subscription would have been applied to the discharge of outstanding obligations. However, under the decision, fifty-five members could draw back reserve tranche positions created by the asset payments for a total of over SDR 0.8 billion either simultaneously or shortly after the payments were made, which meant that actual use of foreign assets was either eliminated or minimized. A total of eighty-seven other members established or increased their reserve tranche positions for an amount totalling over SDR 6.1 billion.

III. Attribution of Reductions in the Fund's Holdings
of Currencies

a. Attribution of reductions in holdings
to reserve tranche positions

The decision to permit a member to attribute, with qualifications, the reduction of the Fund's holdings of its currency to an outstanding repurchase obligation, or to create or enlarge its reserve tranche position was expected to increase the scope for sales of the currencies of members indebted to the Fund provided, of course, the member was considered to be in a sufficiently strong external position and in circumstances in which the member was not subject to early repurchase during the quarterly period. The sale of the member's currency would increase the Fund's usable resources and also facilitate the use of the currency of that member by the Fund because the member would be able to establish a reserve tranche position rather than discharge repurchase obligations in advance of due dates. The option given to a member to receive operational payments in its own currency and create or enlarge its reserve tranche position was intended as an added flexibility for members indebted to the Fund to accept these payments in their own currency, thereby conserving the use of SDRs or the use of other members' currencies which would lead to an improvement in the Fund's liquidity and income positions.

Since the adoption of the decisions, there have been very few operations for which the attribution rules applied. However, during the period April 1981 - February 1983 the Fund sold the equivalent of about SDR 0.5 billion of the currencies of two members (the United Kingdom and Chile) that had outstanding purchases under the oil facility. These operations helped to bolster the Fund's liquidity at a time when it was under considerable pressure and when there was no need to repay immediately the borrowing under the oil facility.

Sales of the currencies of members indebted to the Fund that can be attributed to the reserve tranche are likely to be limited in future. There are now only two members--Kenya and the Philippines--that have outstanding purchases in respect of which the guidelines for early repurchase do not apply because these purchases were made before the applicable decisions were adopted. ^{1/} The guidelines for early repurchase would apply to outstanding purchases in all other cases where the external positions of members are considered sufficiently strong, and

^{1/} Decision Nos. 5704-(78/39), adopted March 22, 1978, and 6172-(79/101), adopted June 28, 1979. (Selected Decisions, Tenth Issue, pages 101-105).

the reductions in the Fund's holdings of members' currencies through early repurchase (or, at the option of the member, through sales of its currency in lieu of repurchase) must be applied to discharge outstanding obligations in amounts up to the calculated amounts of early repurchase. 1/

Up to now, there have been no operational payments in the currencies of members indebted to the Fund. The experience is that almost all remuneration payments--including those to users of Fund credit--are accepted by members in SDRs. The future application of the decision should not, however, be precluded, and it is relevant for members to be given the option as regards the media in which they would accept operational payments while they are indebted to the Fund.

b. GAB

An attribution in the reduction of the Fund's holdings of currency may not be made to the reserve tranche if the member's obligation to repurchase includes an obligation to a purchase financed by borrowing under the GAB. The Fund is obligated to repay the GAB lenders whenever a reduction in its holdings of the currency of a purchaser of borrowed currency, whether resulting from repurchase or other causes, is attributed to a purchase of borrowed currency. 2/ When the GAB was renewed in 1978 participants were not on notice that a change in the attribution rules might make it possible for members to attribute certain reductions in the Fund's holdings of their currency in such a way that the Fund's obligation to repay the lenders would not arise. It was, therefore, not possible to extend the choice of attribution also to members who had purchases outstanding that were financed by GAB resources. The revised GAB, which entered into effect on December 26, 1983, contains the same provision, i.e., there was no legal notice given to the GAB participants of any change in the rule of attribution that might affect them. In fact, there is a strengthening of the requirement on the Fund to repay in that paragraph 11(c) of the GAB decision, as revised in December 1983, requires the Fund to make repayment in relation to reserve tranche drawings as the purchaser's position

1/ The reduction in the Fund's holdings of a member's currency through repurchase cannot be used to create or enlarge the member's reserve tranche position. Reductions in the Fund's holdings of a member's currency in excess of the calculated amount of early repurchase can, of course, be applied to the reserve tranche, but such further reductions through sales or operational payments are unlikely to occur in practice. A proposal has not been made so far for the Fund to sell the currencies of members without their agreement that would be in addition to amounts calculated under the guidelines for early repurchase.

2/ Paragraph 11(c), Decision No. 1289-(62/1), as amended, Selected Decisions, Tenth Issue, page 123.

improves and the Fund makes net sales of its currency. ^{1/} This obligation exists because, in contrast to other borrowing, the Fund may activate and has activated the GAB to finance drawings on their reserve tranche positions in the Fund by GAB participants.

No change is, thus, proposed as regards this exception with regard to the GAB.

c. Attribution of reductions in the Fund's holdings of a member's currency to obligations of that member to repurchase

These relate to the provisions contained in paragraph 1(b) of Decision No. 7059-(82/23), reproduced in Appendix II. The first part provides that an attribution upon the sale of a member's currency or from operational payments in that currency may not be made by a member to an obligation to repurchase financed with borrowed resources unless the Fund is obligated or entitled immediately to repay the lender. The second part supplements the rules regarding the joint reduction in appropriate proportions of obligations financed with ordinary and borrowed resources, in cases where purchases involved a mix of resources. ^{2/}

There were no transactions or operations to which these provisions applied during the period. Nevertheless, the considerations that led to the adoption of this part of the decision, as set out in detail in SM/82/18, continue to apply and there are no proposals for changes.

^{1/} Paragraph 11(c), Decision No. 7337-(83/37), Selected Decisions, Tenth Issue, page 137.

"Whenever a reduction in the Fund's holdings of a drawer's currency is attributed to a purchase of borrowed currency, the Fund shall promptly repay an equivalent amount. If the Fund is indebted to a participant as a result of transfers to finance a reserve tranche purchase by a drawer and the Fund's holdings of the drawer's currency that are not subject to repurchase are reduced as a result of net sales of that currency during a quarterly period covered by an operational budget, the Fund shall repay at the beginning of the next quarterly period an amount equivalent to that reduction, up to the amount of the indebtedness to the participant."

^{2/} See also SM/82/18 "Treatment of Reserve Tranche - Attribution of Reductions in Fund's Holdings of Currencies", January 26, 1982, pages 5-7.

IV. Conclusion and Recommendation

In the staff's view the decisions have worked well. They have been useful in enhancing the asset characteristics of reserve tranche positions in the Fund, and have been beneficial for the Fund's liquidity and income positions, though in relatively modest amounts. In addition, the decisions have provided members with added flexibility in the management of their reserves and in their financial relations with the Fund. There are no reasons to propose changes in the decisions or to schedule a further review of the decisions by the Executive Board. The staff will, of course, keep the operations of the decisions under review, and make proposals to the Executive Board should the need arise to review and change the decisions.

Accordingly, the following decision is proposed for adoption by the Executive Board.

The Executive Board has reviewed Decisions Nos. 6830-(81/65) adopted April 22, 1981, effective from May 1, 1981 and 6831-(81/65), adopted April 22, 1981, effective from May 1, 1981, as amended by Decision No. 7059-(82/23), adopted February 22, 1982. It has concluded that the decisions shall remain in effect without any change.

Exclusion of credit tranches and extended facility

1. Purchases in the credit tranches or under extended arrangements (Decision No. 4377-(74/114), September 13, 1974, as amended), and holdings resulting from such purchases, shall be excluded pursuant to Article XXX(c)(iii) for the purpose of the definition of "reserve tranche purchase."

2. Paragraph 4(a) of the decision on the Extended Fund Facility (Decision No. 4377-(74/114), as amended) shall be amended to provide that

"Purchases outstanding under this decision will not exceed 140 percent of the member's quota, or be allowed to increase the Fund's holdings of the member's currency resulting from purchases in the credit tranches and under this decision above 165 percent of the member's quota."

3. In paragraph 1 of the standard form of stand-by and extended arrangements the words ", after making full use of any reserve tranche that it may have at the time of making a request for a purchase under this arrangement," shall be deleted.

4. The amendment of stand-by and extended arrangements pursuant to paragraph 3 above shall apply also to purchases made and holdings acquired after the date of this decision under arrangements approved prior to the date of this decision.

5. The Fund will review this decision before April 30, 1984.

Decision No. 6830-(81/65),
adopted April 22, 1981
effective from May 1, 1981

Attribution of Reductions in Fund's Holdings of Currencies

1. (a) Subject to paragraphs (b) and (c) below a member shall be free to attribute a reduction in the Fund's holdings of its currency (i) to any of its obligations to repurchase, and (ii) to enlarge its reserve tranche.

(b) If the reduction results from the sale of a member's currency or from operational payments by the Fund, an attribution may not be made to an obligation to repurchase financed from borrowed resources unless the Fund is obligated or entitled immediately to repay the lender on the occasion of such attribution. A member would be able to combine an attribution under this decision to an obligation to repurchase financed with ordinary resources with a repurchase of an outstanding obligation financed with borrowed resources provided this repurchase and the attribution would result in a joint reduction of repurchase obligations as required under Decision No. 5508-(77/127) and Decision No. 6783-(81/40).

(c) An attribution to create a reserve tranche may only be made if the reduction results from the sale of the member's currency or from operational payments by the Fund in that currency and if the member's obligations to repurchase do not include an obligation relating to a purchase financed through borrowing under the GAB.

2. A reduction attributed to a reserve tranche position will not discharge an expectation of repurchase under the Guidelines for Early Repurchase.

3. If the member when asked does not make an attribution in accordance with 1 above, it will be deemed to be discharging the first maturing repurchase obligation.

4. The Fund will review this decision before April 30, 1984.

Decision No. 6831-(81/65),
adopted April 22, 1981,
effective from May 1, 1981,
as amended by
Decision No. 7059-(82/23),
adopted February 22, 1982