**FOR AGENDA**



SM/84/97

May 1, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Charges on Holdings Outstanding Under the Policy on Enlarged Access

Attached for consideration by the Executive Directors is a paper on charges on holdings outstanding under the policy on enlarged access. A draft decision appears on pages 8 through 11.

This subject has been tentatively scheduled for discussion on Wednesday, May 30, 1984.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Charges on Holdings Outstanding Under the Policy on Enlarged Access

Prepared by the Treasurer's Department

(In consultation with the Legal Department)

Approved by W.O. Habermeier

May 1, 1984

1. This note discusses the calculation of charges levied on holdings of currency acquired by the Fund under the Policy on Enlarged Access (EAR) when such holdings exceed the amount of borrowed currency that has been transferred to the General Resources Account to finance these purchases. 1/ Under the present Rule I-6(5), charges are levied only on members' purchases of borrowed currency under EAR and are calculated on the basis of the net cost of borrowing to the Fund. However, a considerable amount of borrowed resources will be repaid out of the Fund's ordinary resources in the period through January 1985 before the corresponding amounts of currency acquired by the Fund under the Policy on Enlarged Access have been reduced through repurchase. The issue will also arise in connection with the new borrowing agreements under which the Fund will borrow SDR 6 billion, because the maturity of loans under the new agreements is 2-1/2 years, while repurchases made with respect to EAR purchases fall within a period of 3-1/2 to 7 years after the date of purchase. This paper, therefore, discusses (i) the inclusion of ordinary resources that are engaged in the financing of EAR purchases in the calculation of charges to be levied on members' EAR purchases made under the Policy on Enlarged Access and (ii) the interest rate to be applied to the ordinary resources so used. 2/

2. It was recognized in 1981 that the amount of EAR borrowing could at times exceed the amount of outstanding EAR purchases financed with borrowed resources and it could at times also fall short of the amount of outstanding EAR purchases. The recognition of such circumstances led to the establishment of the Borrowed Resources Suspense Accounts,

---

1/ That part of the purchase made under an arrangement concluded under the Policy on Enlarged Access that is financed with borrowed resources will be referred to as an "EAR purchase" in this note.

2/ In 1981 the Executive Board in its discussion on the proposed Rule I-6(5) for calculating charges on the use of borrowed funds under EAR was informed of the possibilities of mismatches between the amount of borrowing and its use in financing purchases under EAR and that the staff would make a proposal to the Executive Board regarding the calculation of charges if that seemed necessary. See "Charges to be Levied on the use of Borrowed Funds Under the Policy of Enlarged Access" (SM/81/48, Cor. 1, February 23, 1981) esp. p. 3.

which can hold, and temporarily invest, both the undisbursed proceeds of EAR loans as well as the balances of repurchases which cannot be used in simultaneous repayment of EAR loans. 1/

One element of the mismatch between the amount of EAR borrowing and the outstanding amount of EAR purchases is the time period during which such resources are held in the Borrowed Resources Suspense Accounts. (Balances held in the Borrowed Resources Suspense Accounts have averaged SDR 660 million since the establishment of such Accounts, which compares with total outstanding EAR borrowing of SDR 6.9 billion.)

In addition, over the immediate future there will be a rapid increase in the scale of the mismatch because of the repayment with ordinary resources of the Fund's EAR borrowings under the short-term arrangements with the BIS and with central banks concluded in 1981 which have begun to mature. 2/ The experience to end-March 1984 is that the calculated mismatch in maturities between all outstanding EAR borrowing and corresponding EAR purchases is about six months which means that these outstanding EAR loans will, on average, be repaid six months in advance of repurchases of the EAR purchases that were financed by this borrowing.

It will also be recalled that the loans under the new borrowing agreements with the BIS, Belgium, Japan, and SAMA for a total of SDR 6 billion, provide for a maturity of 2 1/2 years. The Fund would, therefore, begin to repay loans under these new arrangements starting toward the end of 1986 and should complete repayments towards the end of 1988, while repurchases made with respect to these drawings would not normally begin until end-1987, and could run as far as mid-1992. In the absence of additional borrowing to finance the repayments, ordinary resources would be used to effect the repayments of these short-term loans. The use of ordinary resources to finance EAR purchases that were originally financed with borrowed resources would thereby result in ordinary resources accounting for a relatively large proportion of outstanding EAR purchases in the period after 1987.

---

1/ The latter arises not only from a member making a repurchase in advance of due dates, but also because repurchases under the policy on enlarged access are made on a semiannual basis and repayments of loans under some EAR borrowing agreements are made on an annual basis.

2/ See "The Fund's Liquidity and Financing Needs" (EBS/84/44 3/7/84), p. 7. This paper was discussed by the Executive Board at EBM/84/50, April 2, 1984.

Appendix Table 1 shows, on the basis of outstanding purchases financed with borrowed currency, that total repayments to EAR lenders will exceed total repurchases made with respect to these drawings by SDR 1.0 billion in the calendar year 1984 and by SDR 140 million in calendar year 1985. In the subsequent years, repurchases with respect to these drawings will on balance exceed repayments to EAR lenders, although as explained in footnote 1 on page 2, in some six-month periods the reverse is expected to occur. The average length of time before repurchases will augment the Fund's ordinary resources in amounts equal to the amounts used to repay short-term EAR debt is approximately 2 years.

3. As mentioned above, charges are levied on Fund holdings of a member's currency acquired as a result of a purchase financed with borrowed currency under the Policy on Enlarged Access (or EAR purchases) in accordance with Rule I-6(5) and "shall be equal to the net cost of borrowing by the Fund under that Policy...expressed as a percentage per annum plus 0.2 percent per annum." 1/ The "net cost of borrowing" is calculated by taking the amount of interest (and any fees and commissions) actually paid or accrued on borrowing by the Fund to finance EAR purchases, less the net income that the Fund may have received or accrued from the temporary investment of funds held in the Borrowed Resources Suspense Accounts. The rate of charge also includes a small margin (0.2 percent per annum) for the Fund.

Rule I-6(5) provides explicitly for the actual and accrued income resulting from the temporary investment of balances held in the Borrowed Resources Suspense Accounts to be taken into account in calculating the net cost of borrowing, which reduces or, if the rate of return on investments is below the cost of borrowing, would add to the charges paid by the purchaser of borrowed currency under EAR. Rule I-6(5) does not, however, provide for the opposite circumstance with regard to the calculation of charges on EAR purchases: Rule I-6(5) does not make allowance for the inclusion of the cost of the use of ordinary resources in financing EAR purchases when the volume of EAR purchases exceeds the volume of outstanding borrowed currency under the EAR. In view of the circumstances referred to above, it is proposed to amend Rule I-6(5) so that ordinary resources used in financing purchases of borrowed currency under the policy of enlarged access shall be included in the calculation of charges levied on balances acquired as the result of such purchases under the policy of enlarged access. An issue that then arises is the cost at which ordinary resources shall be included in the calculation of EAR charges.

4. In determining EAR charges, the cost of ordinary resources used in the financing of EAR purchases may be added to the net cost of borrowing, and two main approaches can be considered in determining the cost of ordinary resources:

---

1/ Rule I-6(5) is reproduced in Attachment 1.

(i) the cost to the Fund of the use of its ordinary resources may be considered to be reflected by either the current rate of charge or the rate of remuneration or the SDR interest rate; or

(ii) an imputed borrowing cost may be applied to the ordinary resources. Such cost could be the actual average cost of outstanding EAR borrowing, or an imputed interest rate at which the Fund has been able to borrow to finance EAR purchases. The five-year SDR rate adjusted on a six-monthly basis which is paid by the Fund to SAMA under the 1981 loan agreement would be typical of the cost of EAR borrowing.

5. As regards (i), the use of the rate of charge, which reflects the cost to members of their use of ordinary resources, in the calculation of EAR charges would increase the Fund's net operational expense as long as the rate of charge (plus the margin of 0.2 percent) is below the rate of remuneration or the SDR rate, respectively. The rate of remuneration, which is the main element of operational expense, reflects the cost to the Fund of the use of ordinary resources. However, SDRs, which yield a higher rate of interest, might also be involved in the financing of EAR purchases which would increase the cost to the Fund of the use of its ordinary resources in the repayment of EAR borrowing. While conceptually it would be possible to calculate a cost of ordinary resources based on both the rate of remuneration and the SDR interest rate, suitably weighted, in practice such a mixed rate could vary considerably because of changes over the short run in the Fund's holdings of currency or SDRs. Furthermore, because the rate of remuneration will increase over time in relation to the SDR interest rate, the use of one rate or the other will have lessening significance as regards the calculation of EAR charges.

The rate of charge on ordinary resources and both the rate of remuneration and the SDR interest rate are normally below the interest rate paid by the Fund for borrowing from its members to finance purchases under the policy on enlarged access, and the use of any of these rates would result in a lower rate of EAR charges than would otherwise be the case. As pointed out below, the main exception is the GAB on which the Fund pays interest at 100 percent of the combined market rate--i.e., the same as the SDR interest rate.

6. As regards (ii) above, the cost of ordinary resources used to finance EAR purchases could be determined on the basis of an imputed cost of borrowing. For example, the actual average cost of borrowing paid by the Fund could be used as the imputed rate of interest on the use of ordinary resources. However, the actual average cost of borrowing could become unrepresentative if it were based on a relatively small, and possibly diminishing, amount of outstanding EAR borrowing.

It would, therefore, be technically superior to determine the cost of ordinary resources on the basis of a market interest rate that is representative of the Fund's current cost of borrowing for EAR, such as the interest rate to be paid by the Fund on its medium-term borrowing from SAMA under the 1981 loan agreement. It will be recalled that the SDR rate paid on loans from SAMA under the 1981 agreement is calculated on the basis of domestic financial instruments with five-year maturities and which are issued by the governments of the five countries whose currencies are used in the SDR interest rate basket, using the same methodology as that used in calculating the SDR interest rate with the result rounded up to the nearest one-sixteenth of one percent.

7. The impact on EAR charges of the various alternatives which could be used to determine the cost of ordinary resources used in financing EAR purchases would depend on (i) the amount of ordinary resources used in financing EAR purchases; (ii) the duration of use of these resources before new EAR borrowing or scheduled repurchases of EAR purchases would be used to restore the level of the Fund's ordinary resources; and (iii) the spread between short- and medium-term interest rates on SDR-denominated assets and the actual mix of maturities of outstanding borrowed resources. 1/ In general, it might be expected that to use the same rate of charge as is levied on members' use of ordinary resources would result in a lower rate of EAR charge as compared with the use of indicators of the cost to the Fund of the use of ordinary resources. The use of the rate of remuneration would reflect a lower cost to the Fund for the use of its ordinary resources as compared not only with the cost of borrowed resources but also with the SDR interest rate. However, and as noted earlier, as the rate of remuneration approaches equality with the SDR interest rate, the impact of differences between these two rates on the rate of EAR charges will tend to diminish quite rapidly. As can be seen from the footnote below, use of the actual average cost of borrowing and the SAMA rate as indicators of the cost of ordinary resources used in financing EAR purchases are likely to result in only relatively small differences in the calculated rate of EAR charge if the average cost of borrowing would include borrowing bearing the SAMA rate of interest. 2/

8. A number of considerations need to be taken into account in choosing between the different interest rates that could be applied to determine the cost of ordinary resources used in financing EAR

1/ At mid-April, 1984, the SDR interest rate was 8.94 percent and the five-year SDR rate was 10.75 percent, and, of course, the rate of charge levied on members' use of the Fund's ordinary resources was 6.6 percent. The maturities of EAR loans range from 1 to 3 years and from 4 to 7 years.

2/ If the above definitions and mid-April 1984 interest rates were applied to balances of ordinary resources, and also taking into account the borrowed resources that would be involved, the rate of charge on EAR purchases for the six-month period ending June 1985 (i.e., after all short-term borrowing had been repaid) would be as follows:

purchases. First, it would be desirable to keep the cost of using resources under EAR as low as possible, and this would indicate going in the direction of using the rate of charge on members' use of ordinary resources or the rate of remuneration or the SDR interest rate as the cost of ordinary resources used in the financing of EAR purchases. However, if the Fund used the rate of charge that members' paid on their use of ordinary resources, the Fund would experience a reduction in its net income, which would disadvantage non-EAR users because of the inevitable impact on the rate of charge on ordinary resources, and, thus would not be recommended. If the Fund used the rate of remuneration the Fund could conceivably lose income (if, for example, SDRs were used to repay EAR borrowing); it would derive net income from a positive differential between a rate that would be representative of the cost of borrowing and the rate of remuneration. In general, the rate of charge on members' use of ordinary resources would need to be higher if the rate applied to the ordinary resources in financing EAR purchases was related to the cost to the Fund of the use of ordinary resources (e.g., the rate of remuneration) as compared with a rate that was more closely related to the cost of borrowing for EAR. 1/ Furthermore, the employment of ordinary resources to finance EAR purchases is a temporary phenomenon which will affect the rate of charge only during the time that ordinary resources continue to be used for this purpose. In these circumstances, it would seem preferable to minimize variations in the rate of charge levied on EAR purchases that derive from the rate of interest that is applied to ordinary resources used in EAR purchases and which could result in a relative advantage to

2/ (Continued from page 5.)

| | EAR Charges (% p.a.) 1/ |
|---|---|
| 1. Based on rate of charge on use of ordinary resources: | 10.25 |
| 2. Based on cost of ordinary resources: | |
| (i) Remuneration rate 2/ | 10.41 |
| (ii) SDR rate of interest | 10.49 |
| 3. Based on imputed cost of ordinary resources: | |
| (i) Rate on GAB | 10.49 |
| (ii) Outstanding borrowing | 10.64 |
| (iii) Rate to SAMA | 10.67 |

1/ Includes margin of 0.20 percent.
2/ Assuming a remuneration coefficient of 91.66 percent of the SDR interest rate from May 1, 1985.

1/ See "Review of the Fund's Income Position for the Financial Year 1984 and 1985" (EBS/84/91, 4/24/84) esp. p. 16.

those members that make larger use of EAR during the next few years when ordinary resources may be involved in EAR financing to a relatively large extent. It is also to be recalled that it was intended that the level of EAR charges should fully reflect the rate of interest paid by the Fund on borrowing for EAR. Finally, the original repurchase terms will be maintained with respect to EAR purchases that are in part indirectly financed by the Fund's ordinary resources. 1/

The considerations noted above seem to argue for the use of interest rates that are relatively close to the rates at which the Fund normally borrows. There are at present two rates which might be regarded as representative of the cost of Fund borrowing: the rate of interest on the GAB, which is the combined market rate on three-month money market instruments, and the interest rate related to the Fund's medium-term borrowing which is a five-year SDR rate (adjusted semiannually), which is applied to the Fund's EAR borrowing from SAMA. 2/ Since the GAB is usable for financing a wider range of transactions than those in connection with the policy on enlarged access, it would seem that the main rate at which the Fund borrows for EAR, namely the five-year SDR rate paid by the Fund on borrowing from SAMA, would be more representative of the cost of borowing for that policy.

9. On balance, it would not seem inappropriate to use the five-year SDR rate paid by the Fund on its borrowing from SAMA as an indicator of the cost of the ordinary resources that are used in financing EAR purchases.

The use of a medium-term SDR interest rate would not only seem consistent with the original intention that charges on the use of borrowed currency would reflect the net cost of borrowing but also with the fact that the original repurchase terms would be maintained unchanged even though the borrowing that financed the original purchase had been repaid. The use of such a rate would also provide the Fund with some net income compared with the rate that would reflect the cost to the Fund of the use of ordinary resources. This net income would help mitigate the increase in the rate of charge on members' use of ordinary resources that is otherwise required. Finally, as compared with, say, the use of the rate of remuneration, the use of the five-year SDR rate could avoid giving a temporary lower cost advantage to existing (compared with future) users of EAR resources and, in particular, to those with relatively large outstanding use of resources under EAR. Any such advantage would, of course, disappear if the Fund subsequently needed to refinance the ordinary resources used in EAR purchases through new borrowing with the consequential impact on EAR charges.

---

1/ On average, EAR purchases are outstanding for 5.25 years, while non-EAR purchases are outstanding for an average of 4.125 years.

2/ It will also be recalled that the interest rate on Fund borrowing in connection with the Supplementary Financing Facility is a five-year rate adjusted semiannually.

10. In the light of the foregoing, it is proposed that for the purpose of calculating charges on purchases under EAR, the cost of ordinary resources used in financing such purchases shall be imputed at the rate of interest to be paid by the Fund on its borrowing from SAMA under the 1981 loan agreement, and this cost should be added to the "net cost of borrowing".

A draft amendment to Rule I-6(5) is proposed below for the adoption by the Executive Board; its adoption requires a majority of 70 percent of the total voting power.

Draft Decision

Rule I-6(5) shall be amended as indicated below:

"(5) The charge on holdings of a member's currency acquired as a result of the member's purchases of borrowed currency under the Policy on Enlarged Access to the Fund's Resources (Executive Board Decision No. 6783-(81/40)) during a six-month period ending June 30 or December 31 shall be equal to the total of:

(i) the net cost of borrowing by the Fund under that Policy for the period, calculated in accordance with (a), (b) and (c) below and

(ii) the imputed borrowing cost of the amount of the ordinary resources being used to finance purchases of borrowed currency calculated in accordance with (d) below, expressed as a percentage per annum, plus 0.2 percent per annum.

(a) The net cost of borrowing for a six-month period ending June 30 or December 31 shall consist of the actual gross cost of borrowing to finance purchases under the Policy assignable to the period less net income during the period from the temporary employment of the borrowed funds.

(b) Actual gross costs of borrowing shall comprise:

(i) interest paid or accrued to lenders on the average daily amount of balances borrowed; and

(ii) fees, commissions, and any other primary costs directly payable to lenders or incurred in order to secure the borrowed funds, prorated for six-month periods ending June 30 and December 31 in proportion to the duration of the borrowing arrangements to which such costs relate, or to the period covered by these costs.

(c) Net income from temporary employment of borrowed funds pending disbursement shall be determined by taking into account:

(i) income received and income accrued from investments or other operations to secure a rate of return;

(ii) operational expenses (paid and accrued) incurred directly by the Fund in order to obtain this income, prorated over the period to maturity of the investment; and

(iii) any net gain or loss, calculated to the end of each six-month period ending June 30 or December 31, resulting from exchange valuation adjustments of currency balances and investments representing the undisbursed proceeds of borrowing in terms of the SDR.

(d) (i) The imputed borrowing cost of the use of ordinary resources being used to finance purchases of borrowed currency shall be the product of the daily amount of such resources as determined in accordance with (ii) below multiplied by the rate of interest for the weekly period commencing each Monday calculated in accordance with the method set forth in Rule T-1(b) and (c) for determining the rate of interest on holdings of SDRs except that, in place of the rates or yields for the preceding Friday on the instruments listed in Rule T-1(c), the yields for the preceding Wednesday on the instruments specified under paragraph 3(b) of the Annex to the the letter referred to in Executive Board Decision No. 6843-(81/75) adopted May 6, 1981, shall be used.

(ii) The amount of ordinary resources being used to finance purchases of borrowed currency is equal to the amount of the Fund's holdings of currency resulting from members' purchases of borrowed currency under the Policy on Enlarged Access less the outstanding amount of currency borrowed by the Fund to finance such purchases after deducting the amounts of currency held in the Borrowed Resources Suspense Accounts."

Table 1. Repurchases of EAR Drawings and Repayments to Lenders, as of March 31, 1984

(In millions of SDRs)

| Period | Repayments to EAR lenders (1) | Repurchases of Purchases Financed from EAR Resources 1/ (2) | Excess of Repayments over Repurchases 1/2/ (3) |
|---|---|---|---|
| 1983 (June-Dec.) | (89.5) 3/ | -- | -- |
| 1984 (Jan.-June) | 14.57 | -- | 14.57 |
| (July-Dec.) | 1,047.17 | 42.67 | 1,004.50 |
| 1985 (Jan.-June) | 190.77 | 98.26 | 92.51 |
| (July-Dec.) | 195.00 | 147.67 | 47.33 |
| 1986 (Jan.-June) | 137.00 | 203.96 | -66.96 |
| (July-Dec.) | 260.00 | 376.96 | -116.96 |
| 1987 (Jan.-June) | 740.00 | 660.89 | 79.11 |
| (July-Dec.) | 510.00 | 860.69 | -350.69 |
| 1988 (Jan.-June) | 805.00 | 860.69 | -55.69 |
| (July-Dec.) | 510.00 | 818.02 | -308.02 |
| 1989 (Jan.-June) | 828.00 | 762.42 | 65.58 |
| (July-Dec.) | 335.00 | 713.02 | -378.02 |
| 1990 (Jan.-June) | 888.00 | 656.73 | 231.27 |
| (July-Dec.) | 250.00 | 483.73 | -233.73 |
| 1991 (Jan.-June) | 175.00 | 199.80 | -24.80 |
| Total outstanding | 6,885.51 | 6,885.51 | -- |

1/ Assumes the balances held in the Borrowed Resources Suspense Account on March 30, 1984 amounting to SDR 752 million to be drawn during the next quarter.

2/ Minus signs denote that ordinary resources would be augmented through repurchases made prior to repayments.

3/ Repayment of short-term borrowing in the period June-December 1983 amounted to SDR 89.5 million and was made from borrowed resources which fall due for repayment at a later time and are included in the excess of repayments over repurchases at the time of repayment. Over the next few months, ordinary resources will be used to finance purchases under the policy on enlarged access which will take into account this earlier use of borrowed resources.

I—CHARGES AND REMUNERATION

(5) The charge on holdings of a member's currency acquired as a result of the member's purchases of borrowed currency under the Policy on Enlarged Access to the Fund's Resources (Executive Board Decision No. 6783-(81/40)) during a six-month period ending June 30 or December 31 shall be equal to the net cost of borrowing by the Fund under that Policy for the period, calculated in accordance with (a), (b) and (c) below and expressed as a percentage per annum, plus 0.2 per cent per annum.

(a) The net cost of borrowing for a six-month period ending June 30 or December 31 shall consist of the actual gross cost of borrowing to finance purchases under the Policy assignable to the period less net income during the period from the temporary employment of the borrowed funds.

(b) Actual gross costs of borrowing shall comprise:

(i) interest paid or accrued to lenders on the average daily amount of balances borrowed; and

(ii) fees, commissions, and any other primary costs directly payable to lenders or incurred in order to secure the borrowed funds, prorated for six-month periods ending June 30 and December 31 in proportion to the duration of the borrowing arrangements to which such costs relate, or to the period covered by these costs.

(c) Net income from temporary employment of borrowed funds pending disbursement shall be determined by taking into account:

(i) income received and income accrued from investments or other operations to secure a rate of return;

(ii) operational expenses (paid and accrued) incurred directly by the Fund in order to obtain this income, prorated over the period to maturity of the investment; and

(iii) any net gain or loss, calculated to the end of each six-month period ending June 30 or December 31, resulting from exchange valuation adjustments of currency balances and investments representing the undisbursed proceeds of borrowing in terms of the SDR.