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May 20, 1998

To: Members of the Executive Board

From: The Secretary

Subject: **Change in Procedures for the Exchange of Freely Usable Currencies—The Pound Sterling**

Attached for the information of the Executive Directors is a paper on a change in procedures for the exchange of freely usable currencies with regard to the pound sterling. This memorandum will be transmitted to all Fund members.

Mr. Boese (ext. 37626) or Mr. Hatch (ext. 37552) is available to answer technical or factual questions relating to this paper.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

**Change in Procedures for the Exchange of Freely Usable Currencies:
The Pound Sterling**

Prepared by the Treasurer's Department

(In consultation with the Legal Department)

Approved by Günter Wittich

May 19, 1998

1. The attached communication received by the Fund from the Executive Director for United Kingdom sets out new procedures that the United Kingdom intends to follow for exchange of pounds sterling in connection with the operations and transactions of the General Resources Account and transactions with designation conducted through the Special Drawing Rights Department. The new procedures described in this communication have been prepared in consultation with the Fund staff and, in the staff's view, are in accordance with the obligations of the member concerned.

2. Under the Articles, procedures for the exchange of currencies differ depending on whether the currency has been determined by the Fund to be a freely usable currency or not. A freely usable currency means a member's currency that the Fund determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets.¹ All other currencies are non-freely usable. A member whose currency is not freely usable has the obligation to ensure that balances of its currency used in Fund transactions can be exchanged at the time of use for a freely usable currency at exchange rates such that the SDR value is the same for the currency being used and the freely usable currency into which it is exchanged. This is referred to as an equal value exchange.² A member whose currency has been determined by the Fund to be freely usable must exchange its currency at equal value for another freely usable currency only if the member has requested, at the time of use, that such exchange be conducted with its monetary authorities. Otherwise, the issuer of the freely usable currency is required to collaborate with the Fund and members using its currency in Fund transactions and do what can reasonably be expected to assist in the exchange of its currency into another freely usable currency.

¹Article XXX(f)

²This "equal value" principle is set out in Article XIX, Section 7(a) and Rule O-6 regulates the timing of exchanges of currency and the exchange rates to be used in a way that implements this principle.

3. On March 31, 1978, the Fund determined that, until further notice, the Deutsche mark, the French franc, the Japanese yen, the pound sterling, and the U.S. dollar are freely usable currencies. Following that decision and pursuant to Article V, Sections 3(e)(iv) and 7(j)(iv), the United Kingdom requested that members wishing to make exchanges of currency involving the pound sterling do so through the Bank of England. As a result of this established procedure for exchange of pounds sterling, the Bank of England has been obliged to make all such exchanges at the "equal value" exchange rate, as determined under Rule O-2. In contrast, the procedures for exchange of the other freely usable currencies do not require that such exchanges take place through the issuer's central bank. If approached, the French, German, Japanese, and U.S. authorities will make their best efforts to exchange their currencies, or make the necessary arrangements for such exchanges, at the most favorable exchange rate available at the time they are informed of a request for an exchange. The United Kingdom has now requested to bring the procedures for exchange of pounds sterling in line with those for the other freely usable currencies, as it intends to no longer require that such exchanges be handled exclusively by the Bank of England.

4. Rule O-4(c) requires the Fund to inform all members of the (current) procedures for the exchange of each freely usable currency³, and it is intended to circulate the attached communication to all members in advance of the new procedures for exchange of pounds sterling taking effect.

5. The new procedures for exchange of pounds sterling will become effective on June 1, 1998 at the start of the Fund's next operational budget.

Attachment

³Rule O-4 reads as follows:

"(a) The Fund shall consult all members with respect to procedures for the prompt exchange of currency, or to facilitate such exchange in connection with

(i) the operations and transactions of the Fund conducted through the General Resources Account, and

(ii) transactions with designation conducted through the Special Drawing Rights Department.

(b) On the request of any member, an Executive Director, or the Managing Director, the Executive Board shall decide whether procedures under (a) above for the exchange of currency are in accordance with the obligations of members.

(c) The Fund shall inform all members of the procedures for the exchange of each freely usable currency."

International Monetary Fund
Washington, D.C. 20431

April 27, 1998

Dear Mr. Williams:

UNITED KINGDOM: FREELY USABLE CURRENCIES

1. This letter sets out the new procedures for the exchange of currencies that the United Kingdom, through the Bank of England, would propose to follow in line with the Fund's longstanding designation of the pound sterling as a freely usable currency. The following arrangements supersede all previous instructions on this topic.
2. The Bank of England will stand ready to make the necessary arrangements, upon timely request in accordance with Rule O-5, for exchanging into U.S. dollars all balances of sterling acquired by Fund members:
 - (i) from the Fund;
 - (ii) in exchange for a currency received from the Fund;
 - (iii) in an exchange connected with an acquisition of currency for payment to the Fund; and
 - (iv) in a transaction in the Special Drawing Rights Department with designation.
3. The Bank of England will also stand ready to make the necessary arrangements, upon timely request in accordance with Rule O-5, for the exchange of other freely usable currencies into sterling by members needing balances of sterling for payments to the Fund.
4. The Bank of England will use its best efforts to arrange that the exchanges mentioned above are executed at the most favorable exchange rates available in light of prevailing market conditions at the time the Bank of England is informed of the request for the exchange. The timing of the provision of currencies will be in accordance with Rule O-6(c).
5. The United Kingdom, through the Bank of England, will collaborate with the Fund and with members to facilitate the operation of these procedures.

6. These procedures will remain in effect unless modified after consultation with the Fund.

/s/

Gus O'Donnell
Executive Director for
the United Kingdom