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EBS/84/196

CONFIDENTIAL

September 13, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Misreporting and Noncomplying Purchases Under Fund
Arrangements - Guidelines on Remedial Action

Attached for consideration by the Executive Directors is a paper on guidelines on remedial action relating to misreporting and noncomplying purchases under Fund arrangements. A draft decision appears on pages 12 and 13.

This subject has been tentatively scheduled for discussion on Wednesday, October 3, 1984.

Att: (1)

INTERNATIONAL MONETARY FUND

Misreporting and Noncomplying Purchases
under Fund Arrangements--Guidelines on Remedial Action

Prepared by the Legal and the
Exchange and Trade Relations Departments

(In consultation with the Area and Treasurer's Departments)

Approved by George P. Nicoletopoulos and C. David Finch

September 13, 1984

At EBM/84/81, the Executive Board discussed problems that have arisen from time to time regarding the formulation and observance of performance criteria specified in Fund arrangements. The basis for the discussion was the staff memorandum Reporting and Other Problems on Performance Criteria in Fund Arrangements--Legal and Policy Issues (EBS/84/94, April 26, 1984). That memorandum reviewed the nature and incidence of the problems, with particular reference to cases where members have provided incorrect information regarding observance of a performance criterion, and outlined a number of steps that the Fund might take to reduce the likelihood of similar cases arising in the future and to deal with such cases as do occur.

While noting that instances of misreporting and related difficulties are relatively infrequent, Executive Directors emphasized the importance of firm and effective action by the Fund to contain the problem, which could otherwise undermine the credibility of the Fund's policies on conditionality. Among other things, it was agreed that efforts should be made to improve the formulation and definition of performance criteria. If in a particular case a deficiency is discovered in the member's system for collecting and reporting relevant information, appropriate measures should be taken to correct the deficiency and to prevent a recurrence of the problem in the future. In addition, Executive Directors expressed broad support for the view that, where a purchase has been made on the basis of inaccurate information relating to observance of a performance criterion, the Fund should be ready in appropriate cases to call on the member to correct the matter by a repurchase.

This memorandum follows up the earlier general discussion on this point by proposing specific guidelines for dealing with cases of "non-complying" purchases, i.e., cases where it is found, after the event, that the purchase did not comply with the terms of the arrangement because an applicable performance criterion was not observed. The memorandum first reviews the general principles applicable to this situation. On the basis of this review, it recommends that the Fund adopt a policy under which, when the prior nonobservance is established, the member would be called on to take corrective action in the form of a prompt

repurchase, unless the circumstances justify an ex post facto waiver of the nonobservance. The memorandum then discusses in more detail three particular aspects of the proposed policy, namely, the steps leading up to a finding of nonobservance, the basis on which a repurchase would be called for as a result of this finding, and the circumstances in which the nonobservance may appropriately be waived. A draft decision incorporating the guidelines recommended in the memorandum is attached for consideration by the Executive Board.

A. General Principles

It will be useful at the outset to summarize certain relevant principles, which were discussed at greater length in the earlier staff memorandum:

1. Article V, Section 3(b) lays down the basic principle that a member is entitled to purchase resources from the Fund only if the member's use of those resources would be in accordance with the provisions of the Articles and with the policies adopted under them. In the case of purchases under upper credit tranche stand-by arrangements and extended arrangements, the established policy of the Fund is that the member's right to purchase depends on the prior observance of certain performance criteria specified in the arrangement, some of which are expressed in quantitative terms while others relate to actions and measures which the member should take or refrain from taking during the program period. These criteria are designed to enable the member and the Fund to appraise, in an objective and measurable way, the success or otherwise of the member's performance under the program which is being supported by Fund resources. They also serve to determine whether or not the member is entitled to use the Fund's resources under the arrangement. 1/

2. Each individual purchase under an arrangement is at the request of a member, but the purchase takes place only if the Fund is satisfied that the relevant performance criteria have been observed unless--in cases where the staff is aware of nonobservance--waiver has been sought from and approved by the Executive Board. Given the nature of the criteria, the Fund must necessarily look to the member for the information necessary to determine observance or nonobservance. For this purpose the Fund establishes with the member, in the context of each arrangement, reporting requirements and procedures, designed to provide information that is as complete and accurate as possible regarding progress under the program and observance of the specified criteria. The staff carefully reviews the information provided, and makes further enquiries if these seem called for; but if the information appears on its face to be consistent and complete the Fund normally has no reason to question its accuracy. In a very real sense, therefore, the Fund relies

1/ Although the discussion is limited to the observance of performance criteria, the comments apply equally to prior actions by the member on which a purchase under a stand-by or extended arrangement is conditioned, even though these are not formally classified as performance criteria.

on the member for the information that will establish the member's right to make a purchase.

3. Situations can arise in which the information available to the Fund indicates that all performance criteria applicable to a purchase have been observed, when in fact this was not the case. This may be because the information provided to the Fund by the member is inaccurate in some material respect, or because information on some material issue, such as the introduction or modification of an exchange restriction, has not been provided to it at all. In these circumstances, the member may make a purchase which it was not in fact entitled to make under the terms of the arrangement. When later the Fund learns the correct facts, it has a legitimate basis for calling on the member to rectify the situation through repurchase, unless the circumstances are such as to merit an ex post facto waiver of the nonobservance. The justification for this does not lie in the fact that there has been misreporting, as such, but in the fact that the member has acquired resources of the Fund that it was not entitled to acquire under the applicable policies of the Fund and the terms of the arrangement. To permit the member to retain the benefit of the transaction would be to condone a use of the Fund's resources that is contrary to the purposes of the Fund and the provisions of the Articles. At the same time, it is undesirable that members should be exposed indefinitely to the risk that their past transactions may be reopened. Accordingly, the earlier general memorandum proposed that corrective action should only be required if the problem is discovered within two years after the date of the purchase.

4. A requirement that a member take action to correct, through repurchase, a purchase transaction that it was not entitled to make is not a penal action, nor does it necessarily imply any fault on the part of the member, in a pejorative sense. It is true that the transaction would not have occurred in the first place had the member provided the Fund with complete and accurate information about its actions and the status of its program. However, the member's failure to do this will usually be due to a genuine mistake or misunderstanding, or because the member's officials themselves were unaware of the facts, rather than to a deliberate decision to provide inaccurate information or to suppress relevant information. The Fund will need to look into the reasons for the failure, since this will help it and the member to devise effective measures to prevent a recurrence; but the Fund is understandably reluctant to make judgments on motives or to attribute a lack of good faith to a member. Nevertheless, if in a particular case it is clearly apparent that there has been intentional misreporting, the Fund must be ready to act firmly to deal with this, in order to preserve the integrity of the reporting relationship itself.

For the reasons outlined above, it is recommended that the Fund adopt a policy decision under which, subject to the proposed two-year limitation period, a member that is found to have made a noncomplying purchase under an arrangement would be called on to rectify the matter by a prompt repurchase, unless the Fund grants an ex post facto waiver

of the nonobservance. The next section of this memorandum examines the specific elements that need to be taken into account when formulating and implementing the proposed policy.

B. Procedures for Dealing with Noncomplying Purchases

1. The Finding of Nonobservance

Whenever the Fund receives information indicating that a member has made a purchase that it was not entitled to make under the terms of its arrangement, prompt action should be taken to clarify the situation. This will usually involve further enquiries and discussions between the Fund staff and the member, and may require a special mission. The enquiries will be directed, in the first instance, to ascertaining whether in fact there was a nonobservance of an applicable performance criterion. Assuming this is established, it will also be necessary before initiating any corrective action with respect to the purchase to examine why this fact was not brought to the Fund's notice before the purchase occurred, and to consider the broader implications of the nonobservance for the achievement of the objectives of the program. This will be particularly relevant when determining whether or not to recommend that the Fund waive the nonobservance, a question which will often be linked closely to the outcome of consultations with the member on measures necessary to bring the program itself back on track. As a result of the discussions with the staff and management the member may, of course, decide of its own volition to effect a repurchase, in which case there would be no need to initiate formal action in this regard.

The earlier general memorandum proposed that action to correct a past purchase through repurchase should be required only if the purchase had occurred within the previous two years. This limitation period was broadly endorsed by Executive Directors. If a problem of past non-observance exists, it will usually be discovered within a few months after the event. However, in nearly all cases some time will be needed for enquiries and consultations before a definitive finding of nonobservance can be made. Every effort should be made to complete this process as expeditiously as possible, and the member concerned will be expected to cooperate in this regard. Even so, it might not be possible in all cases to conclude the consultation process and make a definitive finding before the end of the two year period. It would, therefore, be appropriate to establish a standard procedure under which, as soon as an apparent problem regarding a purchase that was made within the past two years comes to his attention, the Managing Director will promptly notify the member and indicate the need to enquire further into the matter. The two-year limitation period will cease to run as of the date this notice is sent. If the member has not been given such a notice within two years after the date of the purchase transaction, no action will be taken subsequently to reopen the transaction.

Even where the requisite notice has been given in due time, the member will not necessarily be called on to take corrective action: the

need for such action will arise only if, after any necessary enquiries have been completed, a definitive finding is made that an applicable performance criterion was not observed. As a standard practice, determinations of this nature with respect to prospective purchases are made by the staff and management. Similarly, it would be appropriate for the guidelines prescribing the action to be taken with respect to a past purchase to vest in the Managing Director the responsibility for making the finding of nonobservance. Since a past transaction should not be reopened without good reason, the Managing Director will wish to satisfy himself that there are clear and convincing grounds for concluding that there has been nonobservance, before making a finding to that effect. As soon as he has done this, he will notify the member of his finding, and submit to the Executive Board a report on the matter.

It may be asked whether the member's right to make further purchases under the arrangement would be affected during the period between the initial discovery of an apparent problem and the definitive finding that there has been nonobservance, if such a finding proves warranted. It is considered that this right should, in principle, continue during this interim period: as long as the Fund is satisfied that the performance criteria applicable to a subsequent purchase under the arrangement have been duly observed, there would be no legal basis for interrupting the member's entitlement to make the purchase. It will be recognized, however, that if a doubt has arisen about the accuracy of data purporting to establish observance of a quantitative criterion applicable to an earlier purchase, the Fund will need to examine very carefully the data indicating observance of a similar criterion applicable to a later purchase, before permitting the later purchase to proceed. Moreover, if the doubt relates to observance of a criterion applicable to all purchases under the arrangement--for example, the standard criterion relating to the introduction of exchange restrictions--then later purchases must necessarily be held up until the issue has been definitively resolved.

For the reasons outlined earlier in this paper, it is proposed that a finding by the Managing Director that an applicable performance criterion was not observed should lead directly to corrective action, in the form of a repurchase, unless the nonobservance is waived. In his report to the Executive Board on the matter, the Managing Director would outline the basis for his finding. At the request of the member concerned, the Executive Board might in a particular case decide to review the Managing Director's finding. However, in the absence of any such action by the Board the finding would stand, and the member would be required to repurchase unless the Executive Board decides to waive the nonobservance, and thereby to relieve the member of the repurchase requirement. If the Managing Director considers that the circumstances justify a waiver, he will include a recommendation to this effect in his report.

In the next section of this paper it is recommended that, if no waiver is granted, the member should be obliged to repurchase within a short period after the date of the finding of nonobservance. If it does not effect the repurchase by the due date, it will have an overdue

financial obligation to the Fund, and its right to make purchases under a current arrangement with the Fund will automatically be suspended. Given the fact that the purchase should not have been made in the first place, consideration could be given to including a new provision in arrangements under which this suspension would occur as soon as the finding is made. However, this would not be consistent with the treatment accorded to other financial obligations that are not yet due, and would be difficult to reconcile with the fact that the Executive Board might decide to waive the nonobservance at any time up to the date the repurchase becomes due.

2. The Requirement of Repurchase

The policy guidelines designed to implement these proposals will need to specify the precise period within which the member should effect the repurchase. By analogy with the Fund's practice in the situation arising under the CFF decision where a member has made an excess purchase on the basis of estimated data which later prove to be materially different from the final data, it is recommended that the member be given 30 days after the date it is notified of the Managing Director's finding in which to repurchase. In practice, the member will have been aware of this potential repurchase requirement for a substantially longer period, since the finding itself will conclude a process of enquiry and consultation that may in some cases extend over several months.

The policy guidelines will also need to specify the character of the repurchase requirement, i.e., whether it is to constitute a legal obligation of the member under the Articles. In the exercise of its powers under Article V, Section 7(c) and (d), the Fund may decide to impose a repurchase obligation in the circumstances now being considered. 1/

1/ Article V, Section 7(c) provides in respect of ordinary resources subject to the tranche policies that:

"A member that has made a purchase under Section 3 of this Article shall repurchase the Fund's holdings of its currency that result from the purchase and are subject to charges under Section 8(b) of this Article not later than five years after the date on which the purchase was made. The Fund may prescribe that repurchase shall be made by a member in installments during the period beginning three years and ending five years after the date of a purchase. The Fund, by an eighty-five percent majority of the total voting power, may change the periods for repurchase under this subsection, and any period so adopted shall apply to all members."

Article V, Section 7(d) provides the Fund with similar powers in the case of purchases under special policies, including purchases of the borrowed resources under the enlarged access policy. A power to change repurchase periods includes the power to establish different repurchase periods, which will be uniformly applied in certain specified circumstances.

The broad scope of these powers was recognized by the Executive Board in context of repurchases under the compensatory financing decision, in the following terms:

"Prior to the date of the Second Amendment, the Fund did not have the power to require a purchasing member to accept a repurchase obligation (other than the automatic repurchase obligations of Article V, Section 7), except as a 'term' safeguarding the Fund's interests in cases of purchases involving the granting of a waiver pursuant to Article V, Section 4. Since the date of the Second Amendment, however, the Fund has ample authority to change existing, or to create new, repurchase obligations as it deems appropriate to ensure that the use of its resources is consistent with the purposes of the Fund. Thus, the Fund may, under the provisions of Article V, Section 7(d), decide to require members making purchases under the compensatory financing decision in the future on the basis of estimated data to repurchase promptly, as a matter of legal obligation, the amount of any 'overcompensation.'" 1/

A decision making it obligatory for members to repurchase, within 30 days after the finding of nonobservance, the Fund's holdings of currency resulting from purchases that the member was not entitled to make by the terms of its arrangement would require an 85 percent majority of the total voting power.

Instead of imposing a repurchase obligation, the Fund could decide to include in the guidelines an "expectation" that members would repurchase within the prescribed period. This alternative technique has been used by the Fund in a number of different situations, including certain cases arising under the compensatory financing and buffer stock decisions. A decision which incorporates an expectation of repurchase does not require a special majority, and could be adopted by a majority of the votes cast.

In deciding which of these alternative approaches to adopt, Executive Directors will wish to consider the differing effects of each approach. If a member fails to carry out an obligatory repurchase by the prescribed date, the obligation becomes overdue. Since the member will then be in breach of an obligation under the Articles, it will be liable to action by the Fund to limit the member's further use of the Fund's resources or to declare it ineligible under Article XXVI, Section 2(b). The Fund could initiate similar action under Article V, Section 5, on the ground that the member is using the Fund's resources in a manner contrary to the purposes of the Fund. In addition, by virtue of the standard provision that is now being included in stand-by and extended arrangements, the member's right to make further purchases under the arrangement will automatically be suspended, until such time as the overdue obligation is discharged.

1/ See EBM/82/1, pp. 20-21, and Selected Decisions, Tenth Issue, p. 65.

If, instead of imposing an obligation, the Fund pronounces a repurchase expectation, and a member fails to meet this expectation, this cannot lead to ineligibility action under Article XXVI. On the other hand, it seems clear that such a failure in the circumstances now being considered would give the Fund sufficient grounds for initiating action under Article V, Section 5 to limit the member's right to use the Fund's resources. 1/ In the absence of such action, the fact that the member had failed to repurchase in accordance with the expectation would not, in itself, serve to interrupt the member's rights to draw under a current arrangement with the Fund. However, the Executive Board could decide to extend the scope of the standard provision referred to above, so that it comes into operation not only if there is an overdue financial obligation but also if the member has not fulfilled an expectation of repurchase arising in the circumstances being discussed in this paper.

During the preliminary discussion at EBM/84/81, most Executive Directors appeared to favor the establishment of a repurchase obligation in cases of noncomplying purchases. Given the nature and importance of the situation requiring correction, it is considered that this would be the appropriate course for the Fund to adopt. 2/ An analogy is found in domestic legal systems, which normally impose on a party to a transaction who has received, in error, a payment that it was not entitled to receive under the transaction a legal obligation to return the amount to the other party, when the mistake is discovered.

3. Waiver of Past Nonobservance

Even though it has been found that a purchase did not comply with the terms of the arrangement, the Executive Board could decide to waive the nonobservance on an ex post facto basis. The effect would be to relieve the member of the repurchase obligation--or expectation--that would otherwise arise, so that it could continue to use the Fund's resources derived from the purchase. It necessarily follows that, if a waiver is to be granted, the decision must be taken before the end of

1/ Article V, Section 5 can be invoked if, in the Fund's opinion, a member is using the general resources in a manner contrary to the purposes of the Fund. A member that has acquired from the Fund resources which it was not entitled to acquire, and that persists in retaining the use of these resources even after the Fund has called for their return, would clearly be acting in a manner contrary to the Fund's purposes.

2/ The obligation would apply only to purchases made after the date the decision creating the obligation becomes effective. This is because Article V, Section 7(f) provides that a decision prescribing an obligatory repurchase period that is shorter than the period currently in effect is to apply only to holdings acquired by the Fund after the effective date of the decision.

the 30-day period which, it is recommended, should elapse between the formal finding of nonobservance and the date the obligation (or expectation) arises. If the Managing Director considers that a waiver should be granted, he would propose this, normally for decision on a lapse-of-time basis, in his report notifying the Board of his finding of nonobservance.

It seems desirable to indicate in the proposed policy guidelines the circumstances in which such an ex post facto waiver would usually be granted, so as to assure the uniform treatment of members in similar circumstances. If before a purchase is made the Fund is aware that a relevant performance criterion has not been observed, it may decide to waive observance of the criterion or, in some cases, to modify the criterion, so as to allow the purchase to occur. This is the Fund's usual practice if the deviation is minor or temporary, and the nonobservance does not represent a substantial deviation from the program, i.e., the program is still basically "on track". Even where the program has begun to go substantially "off track", the Fund as a result of further understandings with the member may be satisfied that the member has implemented or is implementing policy measures designed to rectify the problem and achieve the objectives of the program, and may decide to modify the original performance criteria so as to permit purchases to resume on the basis of the modified criteria. It seems appropriate to apply similar principles when determining whether or not to grant an ex post facto waiver after a purchase has been made.

In adopting this approach, the Fund should in principle limit its consideration to the situation of the member as it was at the time the incorrect purchase occurred. If in the circumstances prevailing at that time the Fund would have been expected to permit the purchase to proceed, whether by a direct waiver or following a modification of the relevant criteria, then logically it should be ready to grant an ex post facto waiver with respect to the nonobservance that in fact occurred. It will be recognized, of course, that the principle must be applied with appropriate flexibility. Except in the case of a deviation that is clearly minor, the decision whether to recommend an ex post facto waiver of nonobservance will often be linked with a judgment regarding prospective future performance under the program. However, the very fact that the question is being considered after the event may often make it easier to reach such a judgment. If, for example, the member has made subsequent purchases by the time the previous nonobservance is discovered, and these later purchases were themselves in full compliance with the original or modified terms of the arrangement, this will provide persuasive evidence that the program was not substantially off track at the time of the earlier purchase, and will facilitate the decision to waive the previous nonobservance. If, on the other hand, it is already known by the time the previous nonobservance is discovered that the member has not been

able to meet the criteria for subsequent purchases under the arrangement and that the program is irretrievably off track, this will provide strong (though not necessarily conclusive) evidence that it was also substantially off track when the earlier purchase occurred, and that accordingly an ex post facto waiver would be inappropriate.

It was noted earlier in this memorandum that a finding that there has been nonobservance in relation to an earlier purchase will, in the nature of things, indicate some deficiency in the formulation or implementation of the reporting arrangements established between the Fund and the member concerned. Neither the finding itself, nor a call on the member to correct the matter by repurchase, carry any necessary implication that there has been a lack of good faith on the member's part. In some cases, however, there may be clear and compelling evidence that inaccurate information has been deliberately reported to the Fund, or that information which should have been reported has been deliberately suppressed, in order to induce the Fund to approve a purchase that would not otherwise have been permitted under the terms of the arrangement. This evidence should be brought in an appropriate manner to the attention of the Executive Board, since it may influence the recommendations of the Managing Director and the action taken by the Board in response to these recommendations. Even if the circumstances are otherwise such as to justify a waiver of the nonobservance under the principles described above, the Managing Director may decide not to recommend such a waiver in a particular case if he considers that the purchase was accompanied by misreporting that was clearly intentional and designed to mislead the Fund.

E. Proposed Decisions

Attached for the consideration of the Executive Board is a draft decision adopting guidelines for dealing with future cases where non-complying purchases have been made under stand-by or extended arrangements, as recommended in this paper. The introductory paragraph of the decision outlines the circumstances in which the procedures indicated in the guidelines will be applied, and refers also to the need to take appropriate steps to improve the member's reporting system. Paragraph 1 of the guidelines requires the Managing Director to initiate action under the guidelines, by sending a preliminary notice to the member, whenever evidence of an apparent nonobservance on the case of a purchase made within the previous two years comes to the Fund's attention. Paragraph 2 specifies that, if a finding of nonobservance is made, the Managing Director will promptly notify the member and submit a report to the Executive Board, in which he may recommend that the nonobservance be waived. Paragraph 3 prescribes the corrective action to be taken by the member as a consequence of the finding, in the form of a repurchase within 30 days. The paragraph has been drafted on the assumption that the Executive Board will accept the recommendation made earlier in this memorandum that repurchase should be obligatory, which means that the guidelines would need to be adopted by an 85 percent majority of the

total voting power. Paragraph 4 provides that the Fund, on a case by case basis, may decide to waive the nonobservance, thereby relieving the member of the repurchase obligation that would otherwise arise under the guidelines. The paragraph indicates the circumstances in which a waiver will normally be granted. However, as explained in the previous section of this memorandum, even where these circumstances exist the Managing Director may decide not to recommend a waiver if he considers that the misreporting which led to the purchase was clearly intentional and was designed to mislead the Fund.

If the guidelines, as adopted, incorporate a repurchase obligation, and the member fails to effect the obligatory repurchase within the prescribed period of 30 days, it will have an overdue financial obligation to the Fund. This will lead to automatic suspension of its purchase right under any current arrangement with the Fund. A continuing failure to discharge the obligation would, in due course, also lead to action to limit the member's use of the Fund's resources or to declare it ineligible under the standard procedures now being applied by the Fund for dealing with overdue obligations. These potential consequences are referred to in paragraph 5 of the draft guidelines.

The Executive Board may prefer to include in the guidelines a repurchase expectation, rather than a legal obligation. If so, the attached draft guidelines would need to be suitably modified, and could be adopted by a majority of the votes cast. In this event, the Executive Board may wish to consider two additional measures to reinforce the repurchase expectation. One would be to add to all future stand-by and extended arrangements a provision under which, if a member does not meet the expectation by repurchasing within the prescribed period, its right to make further repurchases will be suspended until the expected repurchase has occurred. The provision, which would apply whether the purchase to which the expectation relates was made under the same or an earlier arrangement, would correspond to that now being included in arrangements under which a member's right to purchase is suspended if it has an overdue financial obligation to the Fund. The second measure would be to adopt a standard procedure, similar to that now being followed for overdue obligations, under which the Managing Director would be directed to initiate action under Article V, Section 5 to limit the member's use of the Fund's resources or to declare it ineligible if after a certain time the member had still not fulfilled the repurchase expectation. If the Executive Board considers that either or both of these supplementary measures should be adopted, the text of the necessary decisions could be circulated for adoption at the same time as the modified version of the draft guidelines.

Draft Decision

Misreporting and Noncomplying Purchases
under Fund Arrangements--Guidelines on Corrective Action

In a few cases, it has been found that a member has made a purchase under a stand-by or extended arrangement which it was not entitled to make by the terms of the arrangement (a "noncomplying purchase"). The purchase was permitted because, on the basis of the information available to it at the time, the Fund was satisfied that all performance criteria or other conditions applicable to the purchase had been observed, but this information later proved to be incorrect. When such a case arises in future, steps should be taken to improve the accuracy and completeness of the information to be reported to the Fund by the member under the arrangement, and the member will also be called upon to repurchase the outstanding amount derived from the noncomplying purchase, unless the Fund decides that the circumstances justify the member's continued use of the purchased resources. To this end the Fund adopts the following guidelines, which shall apply to purchases made after the date of this decision:

1. Whenever evidence comes to the attention of the Fund indicating that a performance criterion or other condition applicable to an outstanding purchase made within the previous two years under a stand-by or extended arrangement may not have been observed, the Managing Director shall promptly inform the member concerned.
2. If, after consultation with the member, the Managing Director finds that, in fact, the criterion or condition was not observed, he shall promptly notify the member of his finding. At the same time, he shall

submit a report to the Executive Board, in which he may recommend that the nonobservance be waived pursuant to paragraph 4 of these guidelines.

3. Within 30 days after the date of the notice referred to in paragraph 2, the member shall be obliged to repurchase from the Fund the outstanding amount of its currency resulting from the purchase, unless a waiver is granted pursuant to paragraph 4.

4. (a) By a decision of the Executive Board, the Fund may waive the nonobservance, in which case the repurchase specified in paragraph 3 need not be made.

(b) A waiver will normally be granted only if the deviation from the relevant performance criterion or other condition was minor or temporary, or if subsequent to the purchase the member has adopted additional policy measures appropriate to achieve the objectives of the program supported by the arrangement under which the purchase was made.

5. If a repurchase required under paragraph 3 has not been effected within the prescribed period, the member's right to purchase under a stand-by or extended arrangement shall be suspended pursuant to the provision in the arrangement for suspension whenever a financial obligation to the Fund is overdue. In addition, the Fund may initiate limitation or ineligibility action under the Articles and Rules, in accordance with its established procedures for dealing with overdue financial obligations.