

**IMMEDIATE  
ATTENTION**

EBS/03/54

April 18, 2003

To: Members of the Executive Board  
From: The Secretary  
Subject: **Procedural Changes to Financial Operations**

Attached for consideration by the Executive Directors is a paper on proposed procedural changes to financial operations.

It is not proposed to bring this matter to the agenda of the Executive Board for discussion unless an Executive Director so requests by **noon on Friday, April 25, 2003**. In the absence of such a request, the draft decisions that appear on pages 7–10 will be deemed approved by the Executive Board, and it will be so recorded in the minutes of the next meeting thereafter.

Questions may be referred to Mr. Hicks (ext. 38280) and Mr. Yuen (ext. 37823) in TRE.

Att: (1)

Other Distribution:  
Department Heads



## INTERNATIONAL MONETARY FUND

### **Procedural Changes to Financial Operations**

Prepared by the Treasurer's and Legal Departments

Approved by Eduard Brau and François Gianviti

April 18, 2003

#### **I. INTRODUCTION**

1. **The Treasurer's Department has undertaken a broad-based renovation of the systems the Fund uses to conduct financial transactions with members, to communicate with members and other financial institutions, and to report on the Fund's finances.** On November 1, 2002, the Fund began transmitting financial communications via the SWIFT network—a worldwide electronic messaging system used by most financial institutions. This change and other ongoing improvements to financial practices and procedures have been warmly welcomed by members.<sup>1</sup> On May 1, 2003, the Treasurer's Department will start using a new state-of-the-art integrated financial system (*iFin*)<sup>2</sup>. This occasion represents an opportune time to update and align certain elements of the Fund's financial procedures with industry best practices, while facilitating the introduction of the new system. This paper proposes amendments to a number of the Fund's Rules and Decisions that are procedural in nature and which will bring a number of benefits to the Fund's membership. The decisions to implement these changes, presented in Section V, may be adopted by a majority of the votes cast.

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<sup>1</sup> The Financial Administrative Control and Tracking System (FACTS), another element of the overall business renewal effort in TRE, was introduced on May 1, 2002, providing an automated, transparent internet-based approach to processing and accounting for the Fund's administrative expenditures. The Executive Board Committee on the Budget was briefed on the main features of FACTS on March 21, 2002.

<sup>2</sup> Staff will brief the Executive Board on the *iFin* system at a future meeting of the Executive Board Committee on the Budget.

2. The following changes are proposed:
- **Adoption of a two-day value date for operations and transactions between the Fund and its members, including the payment of charges, and a two-day valuation rule for exchanges of currency** (i.e., the exchange rate used would be the rate two business days before the value date of the operation or transaction, rather than three business days as at present). This change will require amendments to Rules I-2, O-6, and P-6, and to Decision Nos. 5590-(77/163) and 8165-(85/189). See Decision Nos. 1-5, 7 and 8.
  - **Receipt by the Fund of unscheduled payments and of late payments would be valued at the exchange rate on the day of receipt**, rather than at the exchange rate prevailing three business days earlier. See Decision No. 1.
  - **The Fund would adhere to a financial transaction cut-off time of 5:30 p.m.** in order to permit processing of financial transactions by the end of each business day and for daily account closing. This change requires an amendment to Rule G-4 (a). See Decision No. 6.<sup>3</sup>

The proposed changes have no material impact on the Fund's financial operations and policies.

## II. VALUATION OF CURRENCIES

3. **Under current rules, the exchange rate used in operations and transactions in the Fund's General Resources Account with members is the rate on the date of dispatch of the Fund's instructions for the execution of the transaction or operation, that is, three business days before the value date of the operation or transaction** or, if that rate cannot be used, the rate of the preceding business day.<sup>4</sup> The procedures for valuing currencies in the General Resources Account also apply to payments to and from accounts administered by the Fund (including the PRGF and PRGF-HIPC Trusts and Administered Accounts).

4. **The three-business day rule, adopted in 1978 as part of the overall revision of the Fund's Rules and Regulations during the Second Amendment of the Articles of**

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<sup>3</sup> Decision No. 6 refers to the end of the business day, which under Rule B-4 starts at 9:00 a.m. and ends at 5:30 p.m.

<sup>4</sup> The computations by the Fund relating to the currencies used in its transactions and operations, including the valuation of its holdings of members' currencies for the purpose of maintenance-of-value obligations by members, is governed by Article V, Sections 10(b) and 11, and Article XIX, Section 7(a). For the implementation of this general system of valuation, the Executive Board in 1977 adopted Decision No. 5590-(77/163), effective April 1, 1978, and the O and P Rules.

**Agreement, reflected primarily the technical limitations at that time of making financial settlements.** The Fund's financial operations are global in nature and involve multiple currencies across different time zones. On the one hand, financial transactions (e.g., purchases and repurchases) needed to be executed as promptly as possible after the dispatch of payment instructions to minimize exchange rate risks for all parties concerned. On the other hand, communications for financial transactions were relatively unsophisticated, with authenticated telexes being the primary means for communication and conducting financial transactions.

5. **Since 1978, the Fund has continued to apply the three business day rule in its financial transactions and operations despite rapid advances in communication technology.** The Fund's practice has become out of date in comparison with industry best practices.

- Currency transactions in the *commercial banking sector* typically carry settlement exposures of only a few hours, with pressure for wider use of continuous (or real-time) clearing systems.<sup>5</sup> This trend reflects: (i) the increased speed and sophistication in communications (e.g., via SWIFT); (ii) the integration of payment and settlement systems (e.g., TARGET and the Real-Time Gross Settlements (RTGS) system); and (iii) advances in the technical capacity of financial institutions to effect payments in a timely manner.
- The majority of member *central banks* are already conducting financial transactions on a two-day value or less.
- Other *international financial institutions* (the World Bank, the IADB, and the Bank for International Settlements) are using a two-day currency valuation method.

All members and counterparties, no matter how far apart their time zones are from Washington, would be able to meet payment requirements with two-day notice, particularly given the real-time transmission of electronic messaging and the continuous around-the-clock operations of messaging networks. Members would benefit from a shortening of the period for settlement of financial obligations as exposures to foreign exchange risk are further minimized.

6. **It is also proposed that transactions under accounts administered by the Fund, including for the PRGF and PRGF-HIPC Trusts, be implemented on a two-day value basis.** Since the procedures for valuing payments to and from accounts administered by the

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<sup>5</sup> The Core Principles (IV) adopted by the Committee on Payment and Settlement Systems of the central banks of the Group of Ten countries call for final settlement on the day of value, preferably during the day and at a minimum at the end of the day.

Fund are governed by the same Rules and Decisions as for the General Resources Account, there would be no need to amend the Instruments establishing these Trusts. However, agreements between lenders/contributors and the Fund as Trustee for the PRGF and the PRGF-HIPC Trusts will need to be amended to take into account these changes. Lenders and contributors to these Trusts (Appendix I) have been informed about the proposed change and no lender or contributor has objected.

### III. VALUATION OF LATE PAYMENTS AND UNSCHEDULED PAYMENTS

7. **Currently, the Fund follows the three-business day rule for computations related to settlement of all financial obligations in the General Resources Account and accounts administered by the Fund.** Payments made later than the due date are valued on a three-business day basis. In the case of late receipt of a currency payment from a member, the Fund determines the SDR equivalent of the amount received based on the exchange rate three business days before the date of receipt. If an exchange rate is not available for a currency on the third business day before the value date, the rate of the preceding business day is used, in accordance with Decision No. 5590-(77/163). The same three-business day value is also applied in the case of unscheduled payments, for example, receipt by the Fund of an unadvised grant payment from a contributor to the PRGF Trust, or an unscheduled early repurchase. The practice of valuing an unscheduled payment on the basis of an historical exchange rate is out-of-date. Modern integrated financial systems, such as the *iFin* system being implemented by the Fund, do not typically permit the valuation of payments on a backdated basis because of the required updating of account positions on a real-time basis.

8. **It is proposed that payments received by the Fund after their due date and payments received by the Fund on an unscheduled basis be valued at the exchange rate in effect on the day of receipt, in line with best business practice.**<sup>6</sup> The proposed procedure would value the payment at market value as determined by the spot exchange rate—the practice followed in other financial institutions. To avoid administrative costs both for the members and for the Fund, if a late payment is received within ten business days from the date of the instructions and there is a shortfall/overpayment caused by the difference between the exchange rate used for the instructions and the exchange rate in effect on the day

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<sup>6</sup> Currently there are two exceptions to the general rule. No adjustments to amounts due (because of the use of a different exchange rate) resulting from late payments received within 10 business days of the due date are made for (i) small shortfalls in SDR terms (less than SDR 5,000, i.e. the de minimis rule) or (ii) overpayments (i.e., if the currency used in the transaction has appreciated relative to the SDR). Under the new proposal, there will be no adjustment in the case of an overpayment only if it is within the de minimis rule. See *Review of Valuation of Late Payments in the Fund* (EBS/88/16, 1/29/88) and *Acting Chairman's Concluding Remarks* (5/18/88-88/97).

of receipt of payment, no adjustment will be made if the shortfall/overpayment does not exceed SDR 5,000.<sup>7</sup>

#### IV. CLOSE OF BUSINESS FOR END-OF-DAY PROCESSING

9. **The new financial system (iFin) to be implemented on May 1, 2003 permits rapid settlement of currency exchanges and straight-through-processing of financial operations and transactions.** This will bring substantial advantages to the Fund's membership and to the Fund itself, in the form of more timely access to account balance information, immediate confirmation of payments, and large efficiency gains from straight-through-processing of transactions by the Fund and member central banks. As a result of real-time processing, the Fund will be able to implement daily closing of member positions, rather than delayed closings due to late confirmations of transactions.

10. **To permit daily closings under the new integrated system, the Fund will need to adhere to a strict cut-off time for financial business transactions—in line with best practices in the financial sector and practices in other IFIs.** It is proposed that the cut-off time be set at 5:30 p.m.<sup>8</sup> At a practical level, this would mean that financial transactions authorized by the Executive Board (for example, approval of a purchase under the CFF) after the cut-off time of 5:30 p.m. would only be processed the next business day. In this case, the disbursement to the member would be made on the basis of exchange rates in effect one day after the Board decision for settlement two business days later. Therefore, payment will not be later than at the present time, where a three-day valuation is used.<sup>9</sup> In any event, exceptions would continue to be allowed in the case of a crisis situation when a member may request disbursement in a shorter period, and the Executive Board agrees. This change will not affect the processing of requests for reserve tranche purchases, nor of purchases of currency under a stand-by or extended arrangement (which do not require Board approval). The corresponding instructions for these purchases will continue to be given not later than the close of the first business day following receipt of the request (regardless of the time such requests are received). This is in accordance with Rule G-4 (a) of the Fund's Rules and

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<sup>7</sup> The member whose currency is being used for the payment may still request that the adjustment be made irrespective of costs.

<sup>8</sup> Rule B-4 of the Fund's By-Laws Rules and Regulations establishes the Fund business day as ending at 5:30 p.m.

<sup>9</sup> Under the current situation, if a purchase request is approved by the Board late in the evening, the disbursement instructions are issued that same evening, for payment of funds three business days later.

Regulations, unless it involves the use of borrowed resources, in which case Rule G-4 (b) will continue to apply.<sup>10</sup>

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<sup>10</sup> Under Rule G-4 (b), the value date for a purchase that involves borrowed resources will be either the 15<sup>th</sup> or the last day of the month, or the preceding business day if the day selected is not a business day.

## V. PROPOSED DECISIONS

The following decisions, which may be adopted by a majority of the votes cast, are proposed for adoption by the Executive Board, to take effect on May 1, 2003:

### **A. Change from Three Business Day to Two Business Day Valuation. Same Business Day Value for Late and Unscheduled Payments**

#### **Decision No. 1**

Paragraph 1 of Decision No. 5590-(77/163) shall be amended to read as follows:

“1. The exchange rate for computations by the Fund relating to the currency of a member in the General Resources Account.

(a) on the occasion of the use of that currency in an operation or transaction between the Fund and a member (other than the case specified in (b) below) shall be the rate determined as of the date of the Fund’s instructions for the execution of the transaction or operation, and if this rate cannot be used, the rate of the preceding day closest thereto that is practicable. The value date shall be the second business day after the date of the dispatch of the Fund’s instructions, or as early thereto as is practicable.

(b) Payments received by the Fund after the due date and payments made to the Fund on an unscheduled basis shall be valued at the exchange rate in effect on the day of receipt, provided that, if a late payment is received within ten business days from the date of the instructions and there is a shortfall or overpayment caused by the difference between the exchange rate used for the instructions and the exchange rate in effect on the day of receipt, no adjustment shall be made if the shortfall or overpayment does not exceed SDR 5,000,

unless the member that issues the currency being used for the payment requests that the adjustment be made irrespective of costs.

(c) on all other occasions shall be the rate at which the currency is held by the Fund.”

### **Decision No. 2**

Paragraphs (b) and (c) of Rule O-6 of the Fund’s Rules and Regulations, on the value date for an exchange of currency, shall be amended to read as follows:

“(b) The exchange rate for each currency for the purposes of (a) above shall be determined as of the date of dispatch of the Fund’s instructions for the execution of the transaction or operation under (a) above, and if this rate cannot be used, the rate of the preceding day closest thereto that is practicable.

(c) The value date for an exchange of currency under (a) above shall be the second business day after the date of the dispatch of the Fund’s instructions under (b) above, or as early thereto as is practicable.”

### **Decision No. 3**

The last sentence of Rule I-2 of the Fund’s Rules and Regulations, on payment of charges, shall be amended to read as follows:

“The charges shall be payable on the second business day following the dispatch of the notification.”

**Decision No. 4**

The second sentence of Paragraph V, Section 1 of Decision No. 8165-(85/189) G/TR, on the payment of special charges, shall be amended to read as follows:

“The charges shall be payable on the second business day following the dispatch of the notification.”

**Decision No. 5**

The second sentence of Rule P-6 (a) of the Fund’s Rules and Regulations, on the settlement of transactions in SDRs by agreement, shall be amended to read as follows:

“Settlement shall take place on the date of the agreement or any business day within two business days from that date, as agreed between the participants.”

**B. Cut-off time for Processing of Requests for Purchases**

**Decision No. 6**

The second sentence of Rule G-4 (a) of the Fund’s Rules and Regulations, on the issuance of instructions for a purchase, shall be amended to read as follows:

“Except when the Executive Board decides otherwise, instructions for a transfer of currency shall be given by the Fund on the day of its decision approving the purchase, unless such decision has been taken after the close of the business day, in which case instructions shall be given not later than the close of the first business day following the decision.”

**C. Contributions to the PRGF and PRGF-HIPC Trusts -- Change from Three Business Day to Two Business Day Valuation**

**Decision No. 7**

All operations and transactions under borrowing agreements, administered accounts or in connection with any other form of contribution to the PRGF Trust and the PRGF-HIPC Trust shall be changed to a two business day valuation rule.

**D. Supplementary Financing Facility: Subsidy Account**

**Decision No. 8**

All pending subsidy payments under the Supplementary Financing Facility Subsidy Account shall be made on the basis of the SDR/U.S. dollar exchange rate in effect two business days before the payment date, and, if this rate cannot be used, the rate of the preceding date closest thereto that is practicable.

**Table 1. Bilateral Contributions to the PRGF and PRGF-HIPC Trusts Bound by the Current Agreements, Subject to Modification 1/**

	PRGF Trust		PRGF-HIPC Trust
	Loan Account	Subsidy Account	
1 Algeria	--	--	Deposit Agreement
2 Argentina	--	--	Deposit Agreement
3 Belgium	Borrowing Agreement	Deposit Agreement	--
4 Botswana	--	Deposit Agreement	Investment Agreement
5 Brunei Darussalam	--	--	Deposit Agreement
6 Canada	Borrowing Agreements	--	--
7 Chile	--	--	Deposit Agreement
8 China	Borrowing Agreement	--	--
9 Colombia	--	--	Deposit Agreement
10 Croatia	--	--	Deposit Agreement
11 Czech Republic	--	--	Deposit Agreement
12 Denmark	Borrowing Agreement	--	--
13 Egypt	Borrowing Agreement	--	Deposit Agreement
14 France	Borrowing Agreements	--	--
15 Finland	--	--	Deposit Agreement
16 Ghana	--	--	Deposit Agreement
17 Greece	--	Deposit Agreement	Deposit Agreement
18 Hungary	--	--	Deposit Agreement
19 India	--	--	Deposit Agreement
20 Indonesia	--	Deposit Agreement	Deposit Agreement
21 Iran, Islamic Republic of	--	Deposit Agreement	Investment Agreement
22 Italy	Borrowing Agreements	--	--
23 Japan	Borrowing Agreements	--	--
24 Korea	Borrowing Agreements	--	--
25 Kuwait	--	--	Deposit Agreement
26 Malaysia	--	Investment Agreement	Deposit and Investment Agreements
27 Malta	--	Investment Agreement	--
28 Morocco	--	--	Deposit Agreement
29 Netherlands	Borrowing Agreement	--	--
30 Norway	Borrowing Agreements	--	--
31 Oman	--	--	Deposit Agreement
32 Pakistan	--	Investment Agreement	Deposit Agreement
33 Paraguay	--	--	Deposit Agreement
34 Peru	--	--	Deposit Agreement
35 Poland	--	--	Deposit Agreement
36 Portugal	--	Deposit Agreement	--
37 OPEC Fund for International Development	Borrowing Agreement	--	--
38 Qatar	--	--	Deposit Agreement
39 Saudi Arabia	Associated Agreement (SFD)	--	Memorandum of Understanding
40 Singapore	--	Borrowing Agreement	Investment and Deposit Agreements
41 Spain	Borrowing Agreements	Investment Agreement	--
42 Sri Lanka	--	--	Deposit Agreement
43 St. Lucia	--	--	Deposit Agreement
44 Sweden	--	--	Deposit Agreement
45 Switzerland	Borrowing Agreement	--	--
46 Thailand	--	--	Investment Agreement
47 Tunisia	--	Investment Agreement	Deposit Agreement
48 United Arab Emirates	--	--	Deposit Agreement
49 Uruguay	--	Investment Agreement	Deposit Agreement
50 Vietnam	--	--	Deposit Agreement

1/ This is a list of all creditors to the PRGF Trust and PRGF-HIPC Trust whose agreements have been modified for the change to the two-day value basis. These creditors have been contacted by TRE to seek their concurrence and no member has objected.