

November 14, 1974

To: Members of the Executive Board

From: The Acting Secretary

Subject: Draft Amendments - Revised Draft Amendment of Provisions on Repurchase and Transitional Provisions on Payment of Additional Subscriptions

Attached for consideration by the Executive Directors is a revised draft amendment of the provisions on repurchase and transitional provisions on payment of additional subscriptions.

This subject will be brought to the agenda for discussion on a date to be announced.

INTERNATIONAL MONETARY FUND

Revised Draft Amendment of Provisions on Repurchase and
Transitional Provisions on Payment of Additional Subscriptions

Prepared by the Legal Department

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

Approved by Joseph Gold

November 12, 1974

Redrafted Provisions

The provisions set forth below are revised versions of the texts in DAA/74/2 that have been prepared as a result of the discussion of that memorandum by the Executive Directors at EBM/74/101 (August 9, 1974).^{1/}

124

Part I. Revised Draft

Article V.

Section 7 - Repurchase by a member of its currency held by the Fund

(a) A member shall be entitled to repurchase at any time the Fund's holdings of the member's currency in excess of seventy-five percent of its quota.

(b) A member that has made a purchase under Section 3(b) of this Article shall pay due regard, as its reserves increase, to the desirability of repurchasing the Fund's holdings of the member's currency in excess of seventy-five percent of quota that result from the purchase, and shall repurchase these holdings if the Fund represents to the member that the problem for which it made the purchase has been overcome.

^{1/} The draft provisions would replace the present Article V, Section 7 and Schedule B, and therefore it was not considered necessary to indicate new language by underlining or deletion.

(c) A member that has made a purchase under Section 3(b) of this Article shall repurchase the Fund's holdings of the member's currency that result from the purchase in installments as determined by the Fund, which shall begin not later than three years, and be completed not later than five years, after the date on which the purchase was made, provided that the repurchase shall not be carried to a point at which the Fund's holdings of the member's currency are below seventy-five percent of its quota. The Fund may prescribe other periods for the repurchase of such holdings, provided that different periods shall not be prescribed for the repurchase of holdings acquired pursuant to the same policy on the use of the Fund's resources.

(d) The Fund shall adopt policies for the repurchase of its holdings in excess of seventy-five percent of the quotas of members that are not acquired as the result of purchases under Section 3(b) of this Article, and members shall repurchase such holdings in accordance with the policies.

125

(e) A decision prescribing a period for repurchase under (c) or (d) above shall apply only to holdings acquired by the Fund subsequent to the effective date of the decision.

(f) In exceptional circumstances, the Fund may permit a member to postpone the discharge of any obligation to repurchase, provided that no member shall be permitted to make more than a temporary use of the Fund's resources.

(g) The Fund's policies under Section 3(d) of this Article may be supplemented by policies under which the Fund may decide to sell under Section 3(b) of this Article its holdings of currencies that have not been repurchased

in accordance with this Section, without prejudice, however, to any action that the Fund may be authorized to take under any other provision of this Agreement.

(h) Repurchases shall be made with gold or special drawing rights, or with the currencies of other members specified by the Fund. The Fund shall adopt policies and procedures with regard to the currencies to be used by members in making repurchases that take into account the general principles in Section 3(d) of this Article. Repurchases shall not increase the Fund's holdings of the currency of any member above seventy-five percent of its quota.

(i) A member shall provide its currency, if it has been specified by the Fund under (h) above, to any member requesting the currency for the purpose of repurchase. The currency shall be provided in exchange for any currency convertible in fact on the basis of the rates at which the Fund would sell the currencies involved or for such other currency and at such other rates consistent with the provisions of this Agreement as may be agreed between the members.

126

Schedule B

Transitional Provisions with Respect to Repurchase and Payment of Additional Subscriptions

1. (a) Repurchase obligations that have accrued pursuant to Article V, Section 7(b) before the second amendment of that provision and that remain undischarged at the time the second amendment becomes effective shall be discharged not later than the date or dates on which obligations had to be discharged in accordance with the provisions of this Agreement before the second

- 4 -

amendment. A member may discharge with special drawing rights [or the currencies of other members specified by the Fund] undischarged repurchase obligations that have accrued in gold, and shall discharge the remainder of its obligations in accordance with Article V, Section 7(h).

- (b) The Fund shall return to a member at its request any amount of gold paid by it to the Fund under Article V, Section 7(b) after [August 15, 1971], in exchange for an equivalent amount of special drawing rights [or the currencies of other members specified by the Fund].

2. The currency of a member held by the Fund at the date referred to in 1(a) above in excess of seventy-five percent of the member's quota and not subject to repurchase under 1 above shall be repurchased in accordance with the following rules:

- (i) Holdings that resulted from a purchase shall be repurchased in accordance with the policy on the use of the Fund's resources under which the purchase was made.
- (ii) Holdings that resulted from the payment of an increased subscription in accordance with paragraph 5 of Resolution No. 25-3 of the Board of Governors shall be repurchased in accordance with that paragraph.
- (iii) Other holdings shall be repurchased not later than [three] [five] years after the effective date of the second amendment of Article V, Section 7.
- (iv) Repurchases under this Paragraph shall be made in accordance with Article V, Section 7(h).

3. (a) A member may discharge with special drawing rights any obligation to pay gold to the Fund pursuant to Article III, Section 4(a) that is outstanding at the time the amendment of Article III, Section 4(a) becomes effective.
- (b) The Fund shall return to a member at its request any amount of gold paid by it to the Fund under Article III, Section 4(a) after [August 15, 1971], in exchange for an equivalent amount of special drawing rights[or the currencies of other members specified by the Fund].

Part II. Commentary

This commentary starts with an explanation of the present legal rules on repurchase. The subject is intricate, but an attempt has been made to describe it as briefly as possible. It is necessary to describe the present law and practice in order to explain the changes that would be made by the draft amendments. The explanation of the draft provisions starts on page 15.

Present Legal Rules on Repurchase

The present system of repurchase is based on two systems: repurchases pursuant to Article V, Section 7(b) and certain other provisions, and repurchases pursuant to policies adopted by the Fund under which members are enabled or required to make repurchases. The reason for the establishment of the second system was that the provisions in the Articles on repurchase do not ensure that the use of the Fund's resources will be terminated within a period consistent with the concept of temporary use. Indeed, it is possible that in certain circumstances obligations might never accrue under Article V, Section 7(b). When the Fund started to make its resources more accessible, it became necessary to adopt policies under which members were expected, and sometimes required, to make repurchases in respect of purchases within a specified period. It was also necessary to deal with the media for discharging these repurchases. Although repurchases under Article V, Section 7(b) have been and may still be substantial, over the years repurchases under the latter system have assumed increasing importance. Nevertheless, the system of Article V, Section 7(b) overrides the latter system in the sense that if obligations accrue under Article V, Section 7(b) they must be discharged, and in the media in which they accrue. It is not possible to set aside these obligations and apply the more flexible second system. The mandatory character of Article V, Section 7(b) has created much inconvenience both as to the date at which and the form in which obligations have accrued.

129

The draft amendments are largely designed to codify the simpler and more effective system that has been developed by policies, and to substitute it for the automatic system of Article V, Section 7(b) and associated provisions, while at the same time incorporating certain aspects of the present provisions that should be retained.

Repurchases pursuant to Article V, Section 7(b) and certain other provisions

Repurchase obligations under Article V, Section 7(b)

The three sets of formulae that are of importance for the computation of repurchase obligations under Article V, Section 7(b) are discussed in (1), (2), and (3) below. The concept of monetary reserves is discussed in (4) below.

(1) Calculation of repurchase obligations

Under Article V, Section 7(b)(1) a repurchase obligation may accrue at the end of a financial year of the Fund in an amount equal to one-half of the increase in the Fund's holdings of the member's currency plus one-half of any increase, or minus one-half of any decrease, in the member's monetary reserves. If the Fund's holdings of the member's currency have decreased, the obligation is equal to one-half of any increase in the member's monetary reserves minus one-half of the decrease in the Fund's holdings of its currency. These formulae, which are intended to ensure a temporary use of the Fund's resources, are based on the principles that a member should use its own reserves pari passu with its use of the Fund's resources, and should share with the Fund any increase in its monetary reserves until its use of the Fund's resources is terminated. These principles were never fully applied because of certain qualifications in the original Articles and further qualifications in the amendment. Nevertheless, one consequence of the formulae is that obligations have accrued sometimes before the problem for which a member made a purchase has been overcome. The Fund has never been able to apply the formula in subparagraph (1) of Section 7(b), and the provision has been a dead letter.

(2) Limits on repurchase obligations

130

Four different limits are specified in Article V, Section 7(c). The first one, which is intended to enable a member to restore or build up its monetary reserves, precludes the discharge of a repurchase obligation by a member if its monetary reserves are less than 150 percent of its quota. This limit also precludes the discharge of a repurchase obligation to the extent that the payment would reduce the member's monetary reserves below that level.

The second limit, which is intended to prevent a member from reducing the Fund's holdings below a level deemed desirable for its operations, prohibits repurchase of the Fund's holdings of a member's currency below 75 percent of its quota.

The third limit precludes the use in repurchase of a currency of which the Fund's holdings are at or above 75 percent of the issuer's quota, and prescribes that no currency can be used in repurchase to the extent that the Fund's holdings of it would be increased above that level. (For a discussion of the use of substitute currencies, see page 9 below.) The purpose of this rule is to prevent the creation of a repurchase obligation for a member that has exercised no initiative to use the Fund's resources.

The fourth limit, which provides for an annual limit of 25 percent of quota, was introduced by the 1969 amendment of the Articles. It is amplified by Schedule B, Paragraph 1(e), pursuant to which the remainder of the obligation must be repurchased at the end of the subsequent financial year or years in such a way that total repurchases under Article V, Section 7(b) in any year would not exceed the 25 percent limit. The rationale of the annual limit was that the obligation to repurchase should correspond

in amount to the entitlement to purchase under Article V, Section 3(a).

The application of this fourth limit necessitated the establishment of a method by which the postponement of part of a repurchase obligation could be distributed among the media in which an obligation is payable. This aspect of the limit is referred to on page 9 below.

The limits on repurchase obligations apply as of the end of the financial year for which repurchase obligations are being calculated, and not as of some other date, e.g., the date on which the obligations are calculated or discharged. Developments subsequent to the end of the financial year, even though they occur before the date of the calculation or discharge of a repurchase obligation, do not affect the calculations for that year (Decision No. 419-1, Selected Decisions, p. 64)*. An obligation once calculated is deemed to have been discharged as of the April 30 in respect of which it arose. As a consequence, and in order to avoid distortions of the two principles referred to in (1) above, calculations for later years are modified on the theory that obligations calculated but not discharged have been discharged. Complications of interpretation and calculation arise as a result of the principle of "dating back".

(3) Media of payment

The determination of the form in which repurchase obligations must be paid involves two steps: distribution of the total amount of the obligation among various types of monetary reserves according to certain prescribed formulae, and adjustments, if necessary, to give effect to the limits referred to above (Schedule B, Paragraphs 1 and 2).

131

Distribution of repurchase obligation
when monetary reserves have not increased

If a member has a repurchase obligation at the end of a financial year but its monetary reserves did not increase during that year, the obligation is distributed, for purposes of payment, among the member's gold, special drawing rights, and convertible currencies in proportion to the member's holdings of them at the end of the year.

Distribution of repurchase obligation
when monetary reserves have increased

If a member has a repurchase obligation because its monetary reserves increased during the year, the obligation is distributed, for purposes of payment, among the member's gold, special drawing rights,

* All references to Selected Decisions are to the Sixth Issue. Decisions included in that issue are referred to by page number. The date of adoption is not given in this commentary. For decisions that are not included in the Sixth Issue, the date of adoption is indicated in this commentary.

and convertible currencies in accordance with the following formula:

- (a) That part of the repurchase obligation that is equal to one-half of the increase in the member's monetary reserves is distributed among those types of holdings constituting monetary reserves that have increased in proportion to the amount by which each of them has increased;
- (b) Any further repurchase obligation (i.e., the total repurchase obligation less an amount equal to one-half of the increase in the member's monetary reserves) is distributed among all types of holdings constituting monetary reserves in proportion to the member's holdings of them after deducting that part of the obligation described in and distributed according to (a).

If the discharge of a repurchase obligation as calculated would reduce the member's monetary reserves below the limit of 150 percent of its quota or would reduce the Fund's holdings of the member's currency below the limit of 75 percent of quota, the obligation must be proportionately reduced so that these limits will not be exceeded (Schedule B, Paragraph 1(c)).

132

With respect to the yearly limit of 25 percent of the quota of the repurchasing member, there are complex rules for the distribution of the amount postponed among the media in which the obligation is payable.

Under the original Articles, if the discharge of a repurchase obligation in a member's currency would raise the Fund's holdings of the currency by some amount above 75 percent of that member's quota, the obligation was abated to the extent of the amount above 75 percent. Under the present Articles, that amount must be discharged in convertible currencies as determined by the Fund. The practice of the Fund is to permit a member to use any convertible currency in making the repurchase provided that at the time of discharge the repurchase will not increase the Fund's holdings of any member's currency beyond 75 percent of that member's quota, and provided further that the member making the repurchase has consulted the Managing Director on the currencies, and the amount of each, to be used in the repurchase. The consultation with the Managing Director and the composition of repurchases are based on the Statement entitled "Currencies to Be Drawn and to Be Used in Repurchases" approved by Decision No. 1371-(62/36) (Selected Decisions, p. 36). The Managing Director consults with executive directors before giving advice.

The co-existence of Article V, Section 7(c)(iii) and Schedule B, Paragraph 1(d) with Article V, Section 7(c)(iv) and Schedule B, Paragraph 1(e) has created problems of correlation, because the order in which these two sets of provisions are applied affects the computations. It was decided that Article V, Section 7(c)(iv) and Schedule B, Paragraph 1(e) are to be applied before Article V, Section 7(c)(iii) and Schedule B, Paragraph 1(d).

(4) Monetary reserves

The concept of "monetary reserves" that is of importance for the calculations under Article V, Section 7(b) is governed by Article XIX(a) through (g), Article XXV, Section 7(a), and Schedule B, Paragraphs 3, 4, and 5. These provisions require elaborate reports by members and have raised numerous issues of interpretation that have been the subject of a considerable body of decisions. "Monetary reserves" are calculated for the purposes of two other provisions: Article III, Section 4(a) (which enables the Fund to reduce the proportion of an increased subscription payable in gold for a member with monetary reserves below its new quota on the date of its consent) and Article V, Section 8(f) (under which a member may pay charges in its own currency in a proportion determined by the ratio of its monetary reserves to one-half of its quota on certain dates). Not all the provisions that govern the calculation of monetary reserves for the purpose of repurchase apply to the calculations under these other provisions.

The data on reserves that the Fund requires for purposes other than those referred to in the preceding paragraph are obtained under Article VIII, Section 5, but reserves under that provision are not subject to the provisions that define "monetary reserves".

Holdings included

Monetary reserves include official holdings of gold, convertible currencies, and special drawing rights. Convertible currencies are the currencies of members that have notified the Fund that they are not availing themselves of the transitional arrangements of Article XIV, Section 2 (i.e., "Article VIII currencies" as distinguished from "Article XIV currencies"), as well as the currencies of such nonmembers as the Fund may specify (Article XIX(a) and (d)). The Fund has not specified the currency of any nonmember for this purpose. Under Article XIX(g), the Fund, after consultation with the issuer of an "Article XIV currency", may deem certain holdings of its currency by other members to be holdings of convertible currency in the calculation of monetary reserves. So far, the Fund, acting under Article XIX(g), has "deemed" holdings of two "Article XIV currencies" to be holdings of convertible currencies.

The words "official", "holdings", "currency", "similar fiscal agency", "substantially in excess of working balances" are among the numerous aspects of the definition that have raised problems of interpretation or application and continue to raise new problems even at this date.

Holdings excluded

Under Schedule B, the following holdings of gold and convertible currencies are excluded in calculating monetary reserves for the purpose of repurchase in order to avoid what were regarded as undesirable consequences of the calculations as governed by other provisions:

currency previously inconvertible that became convertible during the year;

gold or convertible currency that can be identified as the proceeds of a long-term or medium-term loan contracted during the year;

gold or convertible currency that has been transferred or set aside for repayment of a loan during the subsequent year.

(Schedule B, Paragraph 3, Decision No. 436-2, Paragraph 2, Selected Decisions, p. 140; Decision No. 510-2, Selected Decisions, p. 141)

The interpretation and operation of the provisions dealing with the exclusions also raise troublesome problems.

Repurchases pursuant to other provisions of the Articles

There are provisions other than Article V, Section 7(b) pursuant to which members are able or required to repurchase their currencies from the Fund. These provisions are explained under the next two headings.

Repurchases under agreements pursuant to Article V, Section 8(d)

Under Article V, Section 8(d) and Rule I-4(g) of the Fund's Rules and Regulations, if the Fund's holdings of a member's currency in excess of quota remain outstanding until the charge on any part of the holdings reaches a specified rate--5.5 percent per annum for holdings resulting from transactions not under a facility to which a special schedule of charges applies--the member must consult with the Fund. That point is reached three years after a purchase. In the course of the consultations, the Fund and the member agree on appropriate arrangements that will ensure repurchase of the Fund's holdings, in amounts equivalent to each purchase, not later than five years after each purchase, unless these holdings are reduced in other ways.

The adoption of additional facilities has increased the complexity of the system. The timing of consultations in respect of purchases under the Oil Facility and the Extended Fund Facility is governed by the rules on charges as they apply to each facility (Rule I-4(f)(3)(ii) and (iii) respectively). For purchases under the Oil Facility, for which the initial rate of charge is 6-7/8 percent per annum, the consultation point is reached after three years, when the applicable rate is 7 percent per annum. For purchases under the Extended Facility, the consultation point is reached four years after a purchase, when the applicable rate is 6 percent per annum. The maximum periods for repurchase under these facilities are seven and eight years respectively.

- 12 -

If the Fund's holdings of a member's currency resulting from purchases in the basic gold tranche have not been reduced within three years after a purchase, the member is requested by the Fund to agree upon an arrangement providing that within five years after each purchase an equivalent repurchase of the Fund's holdings will be made, unless these holdings are reduced in other ways.

The arrangements agreed as a result of consultations under the facilities referred to generally take the form of a schedule providing for the repurchase of specified amounts of the member's currency not later than on certain dates. The installments and periods are governed by the rules of the facility under which the holdings originated. Once agreement is reached, the member has an obligation to repurchase in accordance with it.

Repurchases under Article V, Section 7(a)

A member may at any time repurchase with gold the Fund's holdings of the member's currency in excess of 100 percent of its quota and the Fund must accept such repurchases. The purpose of the provision was to enable a member to terminate the payment of charges to the Fund on holdings of its currency, and this explains why the level of quota was chosen as the level to which a member could insist on reducing the Fund's holdings of its currency. These repurchases, as well as other repurchases outside Article V, Section 7(b), may be discharged with special drawing rights pursuant to Article XXV, Section 7(c)(ii), under which the Fund may accept special drawing rights, to the extent that it may decide, in repurchases other than those under Article V, Section 7(b). The proportions discharged in this way must be, as far as feasible, the same for all members. The Fund has decided to accept special drawing rights in full discharge of repurchases outside Article V, Section 7(b) by all members (Decision No. 2901-(69/122) G/S, reviewed by Decision No. 3188-(70/106) G/S, Selected Decisions, p. 130, and Decision No. 3835-(72/146) G/S, December 20, 1972).

135

Present rules on repurchases pursuant to policies adopted by the Fund

As the limitation on use of the Fund's resources to periods consistent with the Fund's concept of temporary use was not ensured in all circumstances by the operation of the provisions of the Articles, it was necessary to adopt policies by which this goal could be achieved. These policies were also helpful in enabling the Fund to introduce some degree of flexibility into the system of repurchase. For example, the Fund was able to complement the rule that no repurchase obligation accrues under Article V, Section 7(b) if a member's monetary reserves on a particular date are or would be reduced below 150 (originally 100) percent of quota. Repurchases outside Article V, Section 7(b) are not affected by this rule. Similarly, they are not affected by the provision that limits the discharge of repurchase obligations under Article V, Section 7(b) to 25 percent of quota per annum.

In addition, repurchases outside Article V, Section 7(b) can be made in media that serve the interests of the Fund and its members at the time of discharge, as expressed in the quarterly currency budgets and in the decision allowing members to use special drawing rights, and not in media determined by calculations that are mechanistic and relate to an earlier date. Moreover, the policies avoid the problems that arise when calculations under the Articles result in obligations payable in currencies that the Fund cannot accept or in gold. Nevertheless, the policies fall short of ensuring a wholly efficient system of repurchase because obligations arise under Article V, Section 7(b) and must be discharged.

The following paragraphs describe the policies that are designed to ensure that any use of the Fund's resources will be in accordance with the purpose of giving temporary assistance to members. Under these policies members make representations as to their intentions concerning repurchase or are required by the Fund to undertake commitments to repurchase if there is a legal basis for commitments.

Repurchases under Decision No. 7-(648)

136 The Fund has adopted a decision with respect to "voluntary" repurchases, i.e., those repurchases that a member is not obligated to make or that the Fund is not obligated to accept. A member may offer gold, special drawing rights, or convertible currencies in voluntary repurchase of the Fund's holdings of its currency above 75 percent of quota. The Fund may decide whether or not to accept an offer (Decision No. 7-(648), Selected Decisions, p. 66).

Repurchases in respect of purchases under Decision of February 13, 1952

Under a decision adopted on February 13, 1952 (Decision No. 102-(52/11), Selected Decisions, p. 22), a member, when requesting the use of resources under the decision, is expected to state that it will comply with the principles of the decision, which provide that exchange purchased from the Fund should not remain outstanding beyond the period reasonably related to the payments problem for which it was purchased. This period should fall within an outside range of three to five years.

Repurchases relating to purchases under a waiver

Pursuant to Article V, Section 4, the Fund may waive any of the conditions of Article V, Section 3(a) governing the use of its resources on terms that safeguard its interests. The Fund may adopt terms that relate to repurchase. When the Fund grants a waiver in connection with an exchange transaction, the member makes a statement with respect to repurchase and the Fund grants the waiver on the terms of that statement, which then becomes obligatory.

- 14 -

Repurchases under stand-by arrangements

A member purchasing under a stand-by arrangement assumes a commitment in accordance with a standard clause to repurchase the Fund's holdings of currency resulting from the purchase not later than three years after each purchase, to the extent that the holdings have not been reduced by that time. The Fund's practice is to agree to a member's request to repurchase within five years if the member finds repurchase after three years inconvenient.

Repurchases under Oil Facility and Extended Facility

A member requesting a purchase under Decision No. 4241-(74/67), adopted June 13, 1974, is expected to represent that it will make a repurchase corresponding to the purchase, to the extent that it is still outstanding, as soon as the balance of payments problem for which the purchase was made has been overcome and, in any event, in 16 equal quarterly installments to be completed not later than seven years after the purchase. A member that has obtained an extended arrangement under Decision No. 4377-(74/114), adopted September 13, 1974, represents that it will make repurchases as soon as its balance of payments problems have been overcome, and, in any event, within an outside range of four to eight years after each purchase. Not later than four years after the first purchase under the extended arrangement, the member will propose to the Fund a schedule of repurchases for all purchases outstanding under the extended arrangement. Normally, such schedules will provide for repurchases in respect of each purchase in 16 equal quarterly installments.

137Repurchases in respect of purchases under
Compensatory Financing and Buffer Stock Facilities

A member requesting a purchase under the compensatory financing facility (Decision No. 1477-(63/8) as amended, Selected Decisions, p. 42) is expected to represent that it will make a repurchase corresponding to the purchase in accordance with the principles of Decision No. 102-(52/11). In addition, the Fund recommends, as soon as possible after the end of each of the four years following a purchase under the facility, that the member should make a repurchase approximately equal to one-half of the amount by which the member's exports exceeded the medium-term trends of its exports.

Under the facility for the stabilization of prices for primary products (Decision No. 2772-(69/47), Selected Decisions, p. 47), a member is expected to represent that it will make a repurchase corresponding to a purchase in accordance with the principles of Decision No. 102-(52/11) or that it will make a repurchase to the extent of any distribution of currency whenever made under the international buffer stock for the financing of which the purchase was made.

Selection of convertible currencies used in repurchases not under Article V, Section 7(b)

The selection of the currencies to be used in repurchases not under Article V, Section 7(b) is made in accordance with the Statement entitled "Currencies to Be Drawn and to Be Used in Repurchases", approved by Decision No. 1371-(62/36) (Selected Decisions, p. 36). The Statement sets forth that the Fund has the legal authority to specify the convertible currencies to be used in repurchases not made under Article V, Section 7(b). The criteria for the selection of currencies to be used in repurchase are set forth in the Statement. A repurchasing member is required to consult the Managing Director on the currencies, and the amounts of each, to be used in making a repurchase. Until further notice, the convertible currency of any member may be used in repurchase, to the extent that the Fund's holdings would not be increased above 75 percent of the member's quota.

Explanation of Draft Provisions

Introduction

138

The drafts set forth in this memorandum are designed to eliminate many of the complications of the present systems of repurchase and at the same time expressly safeguard the basic principle that any use of the Fund's resources should be temporary.

Among the outmoded features of the present system that would be deleted are the closely defined concept of "monetary reserves" as a determining factor of repurchase obligations and the largely mandatory distribution of repurchase obligations among the components of a member's monetary reserves under Article V, Section 7(b) and Schedule B of the present Articles. Under the draft provisions, a more general concept of reserves would be used. In the selection of the media of payment the interests and preferences of members and of the Fund at the time of payment would play a larger role than has been possible thus far.

Article V.

Draft Section 7(a)

The provision that a member may repurchase at any time the Fund's holdings of the member's currency above 75 percent, read in conjunction with draft subsection (h) which specifies the usable media of payment, would enable members to make such repurchases as a matter of right with gold or special drawing rights. The currencies, which need not be convertible in accordance with Article VIII, of other members could be used if these currencies had been specified for this purpose by the Fund under the policies and procedures adopted pursuant to subsection (h). It could be expected that these procedures would involve appropriate consultations

with the repurchasing member and with the members issuing the currencies. The Fund would be required to adopt policies on the specification of currencies to be used in repurchase (see discussion of draft subsection (h) below). No currency could be used in repurchase to an extent that would increase the Fund's holdings of it above 75 percent of the issuing member's quota.

Draft Section 7(b)

This provision applies to the Fund's holdings of a member's currency in excess of 75 percent of quota that result from purchases. Under the first part of the provision, a member would be bound to pay due regard to the desirability of repurchasing these holdings as its reserves increase. A member would be expected, therefore, to recognize the desirability of repurchase as and when its reserves increase. In view of the unsatisfactory consequences of repurchase obligations determined by fixed formulae, the draft provision does not go beyond requiring members to pay due regard to the desirability of using increases in their reserves to make repurchases.

In its use of the concept of "due regard", the draft provision would be comparable to the present paragraph 1(b) of Schedule G:

"Participants shall also pay due regard to the desirability of pursuing over time a balanced relationship between their holdings of special drawing rights and their holdings of gold and foreign exchange and their reserve positions in the Fund."

139

The words "shall pay due regard" in Schedule G indicate that it is largely for a participant to decide how it observes the principle of harmonization. The words would have the same import in draft subsection (b). The Fund would be able to make representations to a member that it should consider repurchasing because of increases in its reserves, but the representations would not create an obligation to repurchase and the effect of them would be different, therefore, from the representations discussed in the next paragraph.

Draft subsection (b) goes further, however, because it supplements the desideratum referred to above with the principle that if the Fund finds that the problem for which the member made a purchase has been overcome, the Fund may make a representation to that effect to the member. The member would then be required to repurchase. The principle that repurchase should be made when the problem that led to the purchase has been overcome has always been regarded by the Fund as implicit in the provisions relating to repurchase, and is expressly stated in paragraph 2(a) of Decision No. 102-(52/11) (Selected Decisions, p. 22).

The concept of "reserves", as distinguished from "monetary reserves", is relevant in connection with various provisions, such as Article XXV, Section 5(a)(i) (principles of designation) and Schedule F (rules for designation). The information necessary for these purposes is submitted by members pursuant to Article VIII, Section 5, which enables the

Fund to require members to furnish it with the information it deems necessary for its operations. The concept of "reserves" instead of "monetary reserves" was employed in these provisions in order to avoid the definition of the latter concept, which has led to legal and practical difficulties and is in some respects out of date. The more adaptable practices followed in compiling International Financial Statistics could be employed for the purposes of draft Section 7(b).

The abandonment of the concept of "monetary reserves" would result in the abandonment of the forms in which they are reported. This development might deprive the Fund of certain data that it would want to go on receiving. It might be necessary, therefore, to consider the consequences under Article VIII, Section 5.

Draft Section 7(c)

This draft provision also would apply to the Fund's holdings of a member's currency in excess of 75 percent of quota that have resulted from purchases. Under this draft provision, whenever the Fund's holdings of a member's currency were increased above 75 percent of its quota by purchases, an obligation would be created for the member to make repurchases in equivalent amounts. The provision would create the ultimate obligation in the sense that the obligation would apply if repurchase did not take place as a result of draft subsections (a) or (b). Repurchase would have to begin not later than three years after the date on which the holdings were acquired by the Fund and would have to be completed within five years. The installments would be determined by the Fund.

The Fund would be able to substitute another period to replace the period of three to five years as set forth in draft subsection (c). The Fund would also be able to prescribe different periods for the repurchase of holdings of currency in excess of 75 percent of quota resulting from purchases under different policies on the use of its resources. The authority to vary the periods for repurchase would include the authority to change the periods with respect to installments. There are, however, two limitations on the Fund's authority under draft Section 7(c). First, the period prescribed by the Fund for the repurchase of holdings resulting from purchases under a particular policy on the use of its resources would have to be the same for all holdings acquired as a result of such purchases. Second, in order to preclude any retroactive effect of a change in period, draft subsection (e) provides that a policy prescribing the period of repurchase would not apply to currency already held by the Fund on the effective date of the policy.

Draft Section 7(d)

The repurchase provisions of the present Articles apply to all holdings of a member's currency in excess of 75 percent of the member's quota and not merely the holdings that result from the member's purchases.

- 18 -

There are inchoate obligations, therefore, with respect to holdings that result from charges paid in a member's currency, initial or subsequent subscriptions, or administrative receipts. Repurchase obligations with respect to these holdings under amended provisions could be incorporated in draft subsection (c), but there are presentational advantages in dealing with these holdings separately. Moreover, it would seem preferable not to establish a fixed period for the repurchase of these holdings in the Articles, but to rely instead on more flexible procedures.

Draft Section 7(e)

This subsection has been mentioned already in connection with the repurchase of holdings resulting from purchases. The subsection applies also to decisions prescribing periods for the repurchase of holdings originating in other operations. No decision prescribing a period for repurchase would apply to currency held by the Fund on the effective date of the decision.

Draft Section 7(f)

Under this subsection, the Fund would be able to allow a member to postpone the discharge of its repurchase obligation beyond the three to five year period under subsection (c) or such other period as had been prescribed by the Fund under subsection (c) or the period prescribed under subsection (d). The Fund would be able to postpone any installment as part of this power. A postponement could be granted only in exceptional circumstances, of which the Fund would be the judge.

On a few occasions, the Fund has allowed members to postpone the discharge of repurchase obligations under Article V, Section 7(b), most often for reasons related to their balance of payments and reserve position. Under draft Section 7(f) the Fund would be able to grant postponements for any reason it deemed appropriate, but it is stated out of an abundance of caution that no member would be permitted to make more than a temporary use of the Fund's resources. The Fund would decide as at present what period of use would be compatible with this limitation.

Draft Section 7(g)

Under draft Article V, Section 3(d) (see DAA/74/4, Sup. 1), the Fund would be empowered to adopt policies on the selection of currencies for sale to members. The draft of Article V, Section 7(g) would make it explicit that even if a member's currency would not be selected for sale under those policies, the Fund might sell the currency if the member had failed to discharge a repurchase obligation under draft subsection (c) or (d). The sale in these circumstances would be confined to the amount involved in the default. This corrective action would not prevent the Fund from taking any other action that it was authorized to take under other provisions and had concluded that it should take (e.g., under Article V, Section 5 or Article XV, Section 2(a)).

An alternative technique, and possibly a preferable technique, would be to incorporate the substance of draft subsection (g) in draft Article V, Section 3(d) (see DAA/74/4, Sup. 1).

Draft Section 7(h)

This provision, which has already been referred to in connection with draft Section 7(a), would enable members to use gold and special drawing rights as a matter of entitlement in repurchasing under subsection (c) or (d). The currencies of other members could be used if they had been specified by the Fund for this purpose.

The specification of currencies for repurchase would not need to be limited to any class of currencies, such as currencies convertible under Article VIII or convertible in fact. As at present, no currency could be used in repurchase to an extent that would increase the Fund's holdings of it above 75 percent of the issuer's quota. Specification by the Fund would be based on policies and result from procedures that the Fund would be required to adopt. The Fund's duty to adopt policies on repurchase would resemble its duty to adopt policies on purchase as required by draft Article V, Section 3(d) (see DAA/74/4, Sup. 1).

142 Draft Section 7(i)

This draft subsection would require the issuer of a currency specified by the Fund for use in repurchase to make it available, in exchange for currency convertible in fact, to a member intending to make a repurchase.

Specification of a currency by the Fund could be preceded by consultation with the issuing member with a view to accommodating its interest in maintaining a desired composition of its foreign exchange holdings with other relevant interests. These interests would be the interests of repurchasing members in being able to discharge their obligations to the Fund, and the interests of the Fund in reconstituting its holdings of usable currencies. It would be possible to envisage, for example, that these interests could be reconciled by arrangements whereby the Fund's specification of a currency for repurchase would be conditioned on the use of particular currencies for obtaining the specified currency in transactions by repurchasing members with the members issuing currencies to be used in repurchase.

Conversions pursuant to draft Section 7(i) would be made on the basis of the rates at which the Fund would sell the currencies involved at the time of the conversion. The reason for having a standard is that, in contrast to normal market or central banking conversions, the particular currencies to be converted would have been obtained "involuntarily", that is, not as a matter of choice but pursuant to the Fund's policies on the currencies to be used in repurchase. However, the repurchasing member and the issuer of the currency to be used in repurchase could agree that conversion would be made with a currency other than a currency convertible in fact and at an agreed rate of exchange provided that the rate were consistent with the Articles.

- 20 -

Draft transitional provisions of Schedule B

With the adoption of the draft Article V, Section 7, it would be necessary to make provision for the discharge of repurchase obligations that accrue under the present Article V, Section 7(b), as well as commitments or representations as to repurchase, and are undischarged when the amendment becomes effective.

Draft Paragraph 1

Undischarged repurchase obligations pursuant to Article V, Section 7(b) are the subject of draft Paragraph 1(a) of Schedule B. Such repurchase obligations may remain undischarged because under the present Article V, Section 7(c)(iv) repurchase obligations are subject to an annual limit of 25 percent of quota, or because the Fund has granted a postponement to a member in view of its balance of payments and reserve position, or in view of the problems surrounding the payment of gold to the Fund. Under draft Paragraph 1(a), an obligation would have to be discharged not later than the date or dates on which the member was required to discharge the obligation under the present provisions or under decisions of the Fund pursuant to present provisions.

For the obligations subject to draft Paragraph 1(a), there might be a change in the means of payment. That provision would allow members to discharge their repurchase obligations in gold, special drawing rights, or the currencies of other members specified by the Fund. The Fund has allowed a number of members to postpone the discharge of repurchase obligations calculated in gold. In the interim, these members have paid an equivalent amount of special drawing rights in discharge of commitments or representations. These payments did not discharge the repurchase obligations that had accrued in gold under Article V, Section 7(b). The discharge of a commitment is subject to adjustment in order to enable a member to discharge an obligation in the form in which it accrued under Article V, Section 7(b). Draft Paragraph 1(a) would allow members to use special drawing rights in discharge of the portions of their outstanding repurchase obligations that were calculated in gold. The payments already made in special drawing rights could be treated as final under the draft, and no adjustments would be necessary. Members would also be able to use the currencies of other members specified for this purpose by the Fund if the clause in square brackets were retained.

143

Draft Paragraph 1(b) of Schedule B would deal with members that paid gold to the Fund after [August 15, 1971] in discharge of repurchase obligations that were calculated in gold. These members would be entitled to request the Fund to return to them these amounts of gold in exchange for an equivalent amount of special drawing rights or the currencies of other members specified by the Fund.

This provision would give the same benefit to members that have used gold in repurchase under Article V, Section 7(b) as Paragraph 1(a) would give to members that had been granted postponements.

In the computations under Paragraph 1(a) and (b) gold would be accounted for at its equivalent in special drawing rights pursuant to Article XXI, Section 2, i.e., 0.888671 gram of fine gold equals one special drawing right and the Fund's prevailing practice under Article IV, Section 8 and Rule 0-3.

Undischarged repurchase obligations under Article V, Section 7(b) that had not accrued in gold would not necessarily be discharged in the media resulting from the distribution formulae in Paragraph 1 of the present Schedule B. The media of discharge would be governed by draft Article V, Section 7(h), which provides for the use, at the option of the member, of gold, special drawing rights, and the currencies of other members specified by the Fund.

Draft Paragraph 2

Paragraph 2 would deal with the repurchase of currency held by the Fund in excess of 75 percent of a member's quota that was not subject to accrued repurchase obligations under the present Article V, Section 7(b) at the time the amended Articles take effect. Pursuant to rule (i) in the draft, to the extent that the holdings resulted from a purchase, the timing of the repurchase would be determined by the policy under which the purchase was made. The original dates of maturity would thus remain unchanged, and the periods of three to five years, seven years under the Oil Facility, and eight years under the Extended Facility, as from the date when the purchases were made, would continue to apply.

Under rule (ii), the original dates of maturity would also continue to apply in respect of holdings resulting from the payment of increased subscriptions in currency in excess of 75 percent of the increase under paragraph 5 of the Board of Governors Resolution regarding the Fifth General Review of Quotas (Resolution No. 25-3). Under that Resolution a member that paid more than 75 percent of the increase in its quota in currency undertook to repurchase the currency in excess of 75 percent of the increase in five equal annual installments commencing one year after the effective date of the increase in its quota, unless the Fund's holdings resulting from the payment had already been reduced.

For currency holdings resulting from the payment of original subscriptions in excess of 75 percent of quota and from the payment of charges in the member's currency, which under the present Articles and policies are subject to repurchase obligations only under Article V, Section 7(b), repurchase would have to be completed under rule (iii) not later than [three] [five] years after the effective date of the amendment. As an alternative, it could be provided by analogy to draft Article V, Section 7(d) that the repurchase of these holdings should be subject to policies to be adopted by the Fund.

- 22 -

Pursuant to rule (iv), the repurchases dealt with by draft Paragraph 2 would be made in the media set forth in the draft Article V, Section 7(h), i.e., gold, special drawing rights, or the currencies of other members specified by the Fund. In specifying currencies the Fund would have to take account of the principles set forth in draft Article V, Section 3(d), as explained above in the commentary on draft Section 7(h). The 75 percent limit of draft Section 7(h) would apply.

Draft Paragraph 3

Paragraph 3 is designed to solve problems in connection with the payment of the gold portion of an increased subscription in connection with the Fifth General Review of Quotas. The Fund has allowed a member to postpone its payment of gold in connection with the increase in its quota under that Review (Board of Governors Resolution No. 29-3). Under draft Paragraph 3(a) this member would be able to pay special drawing rights instead of gold. The member would thus be placed in the position in which all members would find themselves if special drawing rights could be used instead of gold in the payment of increased subscriptions.

Draft Paragraph 3(b) corresponds to draft Paragraph 1(b) by providing that members that have paid gold in connection with the increases in their quotas under the Fifth General Review after [August 15, 1971] may request the Fund to return to them the amount of gold paid, in exchange for an equivalent amount of special drawing rights or the currencies of other members specified by the Fund. The valuation of gold under Paragraph 3 would be as described above in connection with draft Paragraph 1.

145

Decisions under the amended Article V, Section 7 and Schedule B - Competent organs and majorities

Except for decisions prescribing the period of repurchase of currency paid in excess of 75 percent of subscriptions or increased subscriptions under a general review of quotas, the decisions under draft Article V, Section 7 and Schedule B would be taken by the Executive Directors under the general delegation made by the Board of Governors in Section 15 of the By-Laws. They would take these decisions by a majority of the votes cast.

A decision relating to the period of repurchase of a member's currency paid in excess of 75 percent of its subscription would have to be taken by the Board of Governors pursuant to Article XII, Section 2(b)(i). That provision reserves to the Board of Governors the power to admit new members and determine the conditions of their admission. The prescription of a period of repurchase would require a majority of the votes cast.

Decisions relating to the period of repurchase of currency paid in excess of 75 percent of increased subscriptions under a general review of quotas would have to be taken by the Board of Governors pursuant to Article III, Section 4(c) and Article XII, Section 2(b)(ii). The latter provision reserves to the Board of Governors the power to take any decision dealing with the payment of increased subscriptions under a general review of quotas or with the mitigation of the effects of the payment. A majority of 85 percent of the total voting power would be required for such decisions.

The Executive Directors, by a majority of the votes cast, would grant postponements under Section 7(f) and specify the currencies for use in repurchase under subsection (h), again pursuant to the general delegation by the Board of Governors in Section 15 of the By-Laws.

[The role of the Council, if any, in connection with the powers discussed above is not considered in this memorandum.]