

EB/CQuota/69/2

November 14, 1969

To: Members of the Committee of the Whole  
on Review of Quotas

From: The Secretary

Subject: Fifth General Review - 1970 Regular Election of Executive  
Directors

The attached memorandum will be brought to the agenda of the  
Committee for discussion on a date to be announced.

Att: (1)

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INTERNATIONAL MONETARY FUND

Fifth General Review - 1970 Regular Election of Executive Directors

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

Approved by Joseph Gold

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Introduction

Certain novel problems arise in connection with the 1970 regular election of executive directors and the effective date of quota increases as a result of the Fifth General Review of Quotas. The questions have not arisen hitherto because on the occasion of the earlier general increases a regular election did not intervene between the adoption of the Resolutions of the Board of Governors and the effective date of most of the increases under them. In 1959, the first three Resolutions were adopted by the Board of Governors on February 6, 1959, and the Fourth Resolution on April 6, 1959. The minimum participation required for the effectiveness of increases, namely, 75 per cent of total quotas on January 31, 1959, was attained on September 15, 1959. The increases involved no complications in connection with the 1958 regular election, held on October 9, 1958, or the 1960 election, held on September 30, 1960.

Similarly, the Resolutions resulting from the Fourth General Review were adopted on March 31, 1965, and the prescribed minimum participation, namely,  $66\frac{2}{3}$  per cent of total quotas on February 26, 1965, was attained on February 23, 1966. The increases involved no complications in connection with the 1964 regular election, held on September 10, 1964, or the 1966 election, held on September 28, 1966.

Timing problems in connection with Fifth General Review

If it is assumed that one or more resolutions on quota increases are adopted in mid-January, 1970, there would be approximately eight months before the next regular election, which will be held at the Annual Meeting of the Board of Governors in September 1970, in accordance with Board of Governors Resolution No. 23-10. If a minimum participation were prescribed, it could not be known in advance when it would be attained. If there were no minimum participation clause, so that the increase in any member's quota became effective when the member consented to the increase and paid the further subscription, it could not be known in

advance when any proportion of increases or any individual increase would become effective. These uncertainties could create difficulties in connection with the composition of the Executive Directors because quota increases might become effective up to the moment of the regular election. Therefore, if the resolutions permitted changes in the identity of the five members having the largest quotas and therefore entitled to appoint executive directors under Article XII, Section 3(b)(i), it might not be known until the moment of the election which members were entitled to appoint executive directors. If it were not known which members were entitled to appoint executive directors, it would not be known until that moment which members were to participate in the election of executive directors under Article XII, Section 3(b)(iii) and the last sentence of that section. In addition, it might not be known until the last moment what number of votes members were entitled to cast in the election.

It is obvious that one consequence of this state of affairs would be uncertainty about the groupings of members for the purpose of electing executive directors. The desire to avoid uncertainty of this character has prompted the Executive Directors to formalize a rule which previously had been the subject of an informal understanding. Executive Board Decision No. 1270-(64/32), adopted June 12, 1964, approved the procedure which was described as follows in EBD/64/74 (June 10, 1964):

"Inquiries have been made with respect to the appropriate procedure for dealing with matters which require action by the Board of Governors and which arise in a period closely preceding the annual meeting of that Board. It is suggested that, as a matter of general procedure and provided circumstances of an exceptional nature do not dictate otherwise, such matters should be placed on the agenda of the annual meeting, rather than being handled by mail or cable vote, unless all steps preliminary to referral to the Board of Governors have been completed at least three months in advance of the meeting."

The understanding on which this decision was taken was that resolutions of the Board of Governors permitting the admission of new members or increases in quotas would not be submitted to the Board of Governors for adoption during the period referred to. If any resolution were sent to the Board of Governors in this period, it would normally be sent for adoption at the Annual Meeting only after the impending regular election had been held. In this way, it could be known for some time in advance of the election which members would participate in the election and what their voting power would be, and there would be ample time within which groupings could be arranged on the basis of these assured facts.

If a comparable rule were followed in connection with the Fifth General Review, it would be necessary to provide in the resolution or resolutions resulting from it that no quota increases should become

effective after a certain date well in advance of the 1970 regular election. This provision might be adopted whether or not there was a participation clause. The adoption of a participation clause or a clause under which there would be an interval in which increases could not take effect, or the adoption of both clauses, might mean that some, or even all, quota increases would become effective only after the elections of executive directors. There follows an examination of the consequences of that situation.

The right to appoint an executive director

Article XII, Section 3(b)(i) provides in part as follows:

"(b) There shall be not less than twelve directors who need not be governors, and of whom

(i) Five shall be appointed by the five members having the largest quotas. ..."

Under Article XII, Section 3(f), executive directors continue in office until their successors are appointed or elected. At the Inaugural Meeting of the Board of Governors, an interpretation was requested of the effect of these provisions when a member which was entitled to appoint an executive director under Article XII, Section 3(c)(i) at the time of a regular election ceases to be one of the five members having the largest quotas before the next regular election because of the entry into the Fund of a member with a larger quota. On May 8, 1946 the Executive Directors adopted the following interpretation under Article XVIII:

"The request for interpretation of the Articles of Agreement referred to the Executive Directors by Resolution No. 7 of the Board of Governors was considered. ... It was unanimously agreed that Sections 3(b)(i) and 3(f) of Article XII should be interpreted to mean that any member having one of the five largest quotas at the date of the regular election or at any date between regular elections shall be entitled to appoint an Executive Director who will hold office until the next regular election without prejudice to the right of a subsequently admitted member to appoint a Director if it has one of the five largest quotas." (Decision No. 2-1, Selected Decisions, Third Issue, p. 95)

One effect of this interpretation is that a member that is entitled to appoint an executive director at the date of a regular election does not lose that right before the next regular election if it ceases to be one of the five members with the largest quotas. Moreover, a country that between regular elections becomes one of the five members having the largest quotas acquires the right to appoint an executive director

forthwith. The interpretation was inspired by the prospect that the state of affairs adverted to might be brought about by the entry into the Fund of a new member between regular elections. Nevertheless, it would not be justifiable to confine the interpretation to the case of a new member that has one of the largest quotas and to distinguish the case of a member that acquires one of the largest quotas as the result of an increase in its quota. One reason why this distinction should not be made is that the interpretation appears to have been based on the principle that the Articles do not permit the disfranchisement in the Executive Directors of a country that is a member of the Fund at the date of a regular election (see Selected Documents, Board of Governors Inaugural Meeting, p. 39). If a member's right to have an appointed executive director ceased between regular elections, it would be disfranchised because there would be no elected executive director towards whose election the votes of the member had counted. An elected executive director can cast only the number of votes allotted to members whose votes counted towards his election (Article XII, Section 3(i)).

A further refinement of the legal position as explained in the preceding paragraph must be noted. Suppose that a resolution on quota increases were to permit increases by which Quota No. 5 could be exceeded by Quota No. 6 and Quota No. 7 with Quota No. 6 ranking ahead of Quota No. 7, and that the increase in Quota No. 7 became effective before the increase in Quota No. 6. Member No. 7 would become entitled to appoint an executive director without prejudice to the continued right of Member No. 5 to have an appointed executive director and the right of Member No. 6 to appoint an executive director when its increase became effective. This is the effect of the interpretation of May 8, 1946. It would follow that until the next regular election, all three members, Nos. 5, 6, and 7, would appoint executive directors. When an additional executive director has been appointed under Article XII, Section 3(c), the number of executive directors to be elected under Section 3(b)(iii) has been reduced so as to avoid an increase in the number of executive directors. In the example that has been discussed, the number of executive directors would be increased to 22 until the next regular election.

It is possible to imagine that in certain circumstances there would be no addition to the number of executive directors. For example, suppose that Member No. 6 had elected an executive director on its own. When its quota is increased, it must appoint an executive director. If the elected executive director were to resign, a by-election could not be held because there would be no members eligible to participate in it. This situation occurred when the quota of Germany was increased in September 1959, and became one of the five largest quotas. There is no record of any consideration of the effect of that event.

#### The duty to appoint an executive director

If a member becomes entitled to appoint an additional executive director under Article XII, Section 3(c), it must exercise that right, and it has no option to forbear in order to continue to have the number

of votes allotted to it cast by an elected executive director. This was the conclusion reached in Document No. 3 of the 1950 Committee on Rules for Election of Executive Directors in connection with the entitlement of a member to appoint an additional executive director under Article XII, Section 3(b)(ii) and Section 3(c). The conclusion was the basis for determining the number of executive directors when the rules for election were prepared in 1958 and again in 1968.

One of the reasons for the conclusion with respect to additional appointed executive directors under Section 3(c) was that the language of Section 3(b)(iii) and (iv) prevents a member entitled to appoint an executive director from participating in an election of executive directors. In the circumstances now discussed the member becoming entitled to appoint an executive director between regular elections has already participated in an election. Nevertheless, the same conclusion should apply. The interpretation of May 8, 1946 refers to the member as "entitled to appoint" and it was similar language in Section 3(c) that has been understood to mean that the member is required to appoint. A further, and perhaps more important consideration, is that the appointment of executive directors is a feature of the public policy of the Fund that is not subject to dispensation by members. The public policy of Section 3(c) is to ensure that executive directors will be able to present the views of the two largest "creditor" members in the Executive Directors. Similarly, the public policy of Section 3(b)(i) is to ensure that executive directors will be able to present the views of the five members having the largest quotas without having to present the views of other members as well.

#### The identity of executive directors

The member that becomes entitled to appoint an executive director between regular elections may have one of its nationals among the Executive Directors already serving as an elected executive director. Presumably, the member will want to appoint a national to serve as its appointed executive director. This does not affect the office of the elected executive director. Executive directors are elected as persons and not as the nationals of any particular member country. Nothing is said in the Articles, By-Laws, or Rules and Regulations about the nationality of executive directors.

The conclusion that the elected executive director continues in office results from the first sentence of Article XII, Section 3(f):

"Directors shall continue in office until their successors are appointed or elected."

The executive director appointed between regular elections is not the successor of the elected executive director, because he does not cast the number of votes allotted to the non-appointing members and cast by the elected executive director.

If the elected executive director were to resign, however, it may be presumed that the member appointing an executive director would cease thereafter to have two nationals among the Executive Directors. The rest of Section 3(f) provides that:

"If the office of an elected director becomes vacant more than ninety days before the end of his term, another director shall be elected for the remainder of the term by the members who elected the former director. A majority of the votes cast shall be required for election. While the office remains vacant, the alternate of the former director shall exercise his powers, except that of appointing an alternate."

Under this provision, the members other than the one appointing the executive director would participate in the by-election of an executive director. It is true that the provision refers to "the members who elected the former director." These words should be understood nevertheless to exclude the member appointing an executive director. This is the implication of the rule, in Section 3(b)(iii) and (iv), that regular elections are confined to members that are not entitled to appoint executive directors. Moreover, if this conclusion were not adopted, a member's voting power would be doubled because both its appointed executive director and an elected director would cast votes that equalled or included the number of votes allotted to the member.

For this same reason, the votes cast by the elected executive director must be diminished by the votes cast by the appointed executive director even if the elected executive director continues in office and a by-election is not held. The second sentence of Section 3(i) reads as follows:

"Each elected director shall be entitled to cast the number of votes which counted towards his election."

If the votes of the appointing member are not excluded from these votes, its voting strength would be doubled.

#### Effect of quota increase on votes

The sentence in Section 3(i) quoted in the preceding paragraph raises another question. A member's votes are governed by Article XII, Section 5(a):

"(a) Each member shall have two hundred fifty votes plus one additional vote for each part of its quota equivalent to one hundred thousand United States dollars."

This appears to refer to the quota of a member as it may be from time to time. Does it nevertheless follow from Section 3(i) that the votes cast by an elected executive director are fixed as of the date of his

election and that subsequent changes in the quotas of the members electing him have no effect on the votes he casts? The answer is provided by Decision No. 180-5 of June 27, 1947:

"A change in the quota of a member between regular biennial elections will change by the same amount the voting power of the elected Executive Director who casts the votes of the member." (Selected Decisions, p. 96)

Effective date of quota increases

If most quota increases were to become effective within a convenient period before the 1970 regular election, many of the complications that have been discussed would be avoided. It cannot be assumed, however, that this will occur. A number of techniques can be considered in order to moderate the complications, although it cannot be asserted that any one technique will eliminate all difficulties.

(i) Participation. In the Third and Fourth General Reviews a minimum participation was required as a condition precedent to the effectiveness of any quota increases. This was declared to be appropriate because of the cooperative character of a general increase. If a minimum participation were prescribed on this occasion, and it were to be attained before the 1970 regular election, this might make a certain contribution to the avoidance of complications. Of course, the greater the prescribed participation, the greater would be the prospect that difficulties would be avoided. It should also be noted that a participation clause does not have to be written in terms of a percentage or exclusively in that form. For example, it would be possible to provide that quota increases might become effective before the election when the consents and subscriptions received included those of the five members that could have the largest quotas under the resolution or resolutions.

(ii) Period of quiescence. In view of past practice in connection with elections, it would seem desirable, if quota increases were allowed to take effect before the 1970 regular election, to have a sufficient period before the election in which quota increases would not become effective. This would mean that even if the minimum participation had been attained before the beginning of the period, no further increases would become effective during the period. It would mean also that no increases at all would become effective if the minimum participation were attained during the period.

(iii) Postponed effectiveness. It would be possible to prescribe that no quotas would become effective until after the regular election whether or not a minimum participation clause were satisfied before the election. The earliest date for effectiveness could be, say, October 31, 1970, or any later date on which the prescribed participation was attained. Alternatively, December 31, 1970 could be fixed as the date.

This would be the latest date on which increased quotas could serve as the basis for the allocation of special drawing rights on January 1, 1971. If effectiveness were postponed until December 31, 1970, it might be desirable to consider whether any participation clause was useful, on the assumption that most members would be in a position to consent to increases and pay their subscriptions by that date.

(iv) Postponed election. If it were thought useful to gain a few weeks, the Board of Governors could be invited to amend Resolution No. 23-10 so that the 1970 regular election of executive directors could be held by cable late in October 1970 instead of at the Annual Meeting.

#### Requirements for effectiveness

Under the Resolutions resulting from the Fourth General Review, the increase in a member's quota could not become effective unless three conditions had been satisfied: the member consented to the increase, the member paid in full the subscription equal to the increase, and the minimum participation had been attained. Only the first of these conditions is required by the Articles.

If these three conditions were retained in connection with the Fifth General Review together with a condition that no increases should take effect until December 31, 1970, members would need to ensure that the payment of subscription was completed before that date. In some cases, this may require consent before December 31, 1970 because it may not be possible for some members to make payments in advance of consent. In other cases, payment would have to precede December 31, 1970 if consent were deferred until that date.