FOR AGENDA

SM/86/106

May 16, 1986

To: Members of the Executive Board

From: The Acting Secretary

Subject: Valuation of Assets in the General Resources Account - Provisioning and Write-off - Legal Considerations

The attached paper, together with the paper on provisioning against loan losses in the context of the Fund (EBS/86/82 and Correction 1 and Supplement 1), has been scheduled for discussion on Monday, May 19, 1986.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Valuation of Assets in the General Resources Account--
Provisioning and Write-off - Legal Considerations

Prepared by the Legal Department

(In consultation with the Treasurer's Department)

Approved by Francois Gianviti

May 16, 1986

At the meeting of the Executive Board on April 30, 1986, in response to questions of Executive Directors, the Director of the Legal Department stated that, under the Articles of Agreement, the Fund's holdings of currencies in the General Resources Account could not be "written off", but that this did not mean that provisioning could not be made in the context of the Fund.

At the meeting of the Executive Board on May 9, 1986, further elaboration on these issues was requested.

In response to the request, this paper examines the legal aspects of (i) the valuation of the Fund's holdings of currencies, and (ii) the concept of "loss in value" with respect to the Fund's holdings of currencies.

1. Valuation of the Fund's holdings of currencies in the General Resources Account

The Fund's transactions with its members in the General Resources Account under Article V, Section 3 can only take the form of sales of currencies or SDRs for an equivalent amount of the purchasing member's currency (Article V, Section 2(a)). These transactions cannot take the form of loans.

The Fund's holdings of the purchasing member's currency can be sold by the Fund to other members in accordance with the Fund's policies on the selection of currencies (Article V, Section 3(d)).1/ They must be repurchased by the member, after the prescribed period, to the extent that they are subject to periodic charges (Article V, Section 7(c) and (d)).

1/ Particular policies may be adopted by the Fund for the sale of its holdings of currencies of members in arrears (Article V, Section 7(h)).

(a) Principles of valuation

The valuation of the Fund's holdings of a currency must be made in accordance with the provisions of Article V, Sections 10 and 11: the value of each currency must be expressed in terms of SDRs; the SDR rate for a currency is determined in accordance with Article XIX, Section 7(a) and Rule O-2; the SDR rate for a currency applies to the Fund's transactions in that currency, to transactions between participants involving SDRs and that currency, and to the valuation of the Fund's holdings of that currency.

Once the SDR rate for a currency has been determined, it applies to all of the Fund's holdings of that currency, regardless of the fulfillment or nonfulfillment by the member of its repurchase obligations. Therefore, the Fund's holdings of a currency cannot be "written off," i.e., accounted for below the SDR rate, even when the member is in arrears.

There may be cases in which the determination of the SDR rate for a currency is difficult, but it does not mean that the Fund could decide not to determine a rate, or to determine a zero rate (except if the currency had disappeared): the nondetermination of a rate would be inconsistent with the provisions of Article V, Section 10, and the determination of a zero rate would amount to a nondetermination because any existing currency, however depreciated, has a residual value.

(b) Maintenance of value

Under Article V, Section 11, the value of the Fund's holdings of currencies in the General Resources Account must be maintained in terms of SDRs. If the member's currency has depreciated, it will have to pay an additional amount to the Fund; if it has appreciated, the Fund will return the excess amount to the member. The requirement of maintenance of value applies also to securities that have been substituted for currency in the General Resources Account under Article III, Section 4.

The adjustment, which is a recalculation, of the Fund's holdings must be made on the occasion of the use of that currency in an operation or transaction between the Fund and another member, and at such other times as the Fund may decide or the member may request (Article V, Section 11(b); see also Decision No. 5590-(77/163), December 5, 1977, effective April 1, 1978, and Commentary on the Proposed Second Amendment, 1976, pp. 42-43).

After the adjustment, the member or the Fund must make the necessary payments. Between the adjustment and the payment by the member, the Fund has a claim on the member; the claim ("account receivable") is deemed to be part of the Fund's holdings of the member's currency; payment by the member must be made "within a reasonable time, as determined by the Fund" (Article V, Section 11(b); see also Decision No. 5590 and the Commentary referred to above).

2. Concept of "loss in value" with respect to the Fund's holdings of currencies

(a) The nonfulfillment by a member of certain obligations under the Articles does not necessarily result in a loss for the Fund:

- the nonfulfillment of a repurchase obligation has a negative impact on the liquidity of the Fund, but it does not affect the SDR value of the Fund's currency holdings if the SDR rate for the member's currency has not changed or if, assuming that the rate has changed, the maintenance of value provisions of Article V, Section 11, have been complied with;

- the nonfulfillment of the maintenance of value obligation reduces the value of the Fund's holdings, but it does not reduce the value of the Fund's assets because the Fund has a claim for the difference on the member.

(b) The concept of loss is used in the Articles of Agreement in two instances: in connection with the liquidation of the Fund (Schedule K, paragraph 8) and the withdrawal of a member (Schedule J, paragraph 6). Thus, a loss will occur if a member, after withdrawing from the Fund, does not repurchase the Fund's excess holdings of its currency and does not make good the loss incurred by the Fund in selling those holdings in an orderly fashion in a market. The question may be raised whether, in the Fund's books, the actual loss would be shown after the "loss in the market" or only after the member has refused to pay the Fund's claim for the loss, but in the practice of the Fund the question has not arisen because all withdrawing members have discharged their obligations to the Fund, pursuant to settlement agreements, without the need for the Fund to sell currencies in a market.

If the Fund determined that there was a probability that a loss could arise in connection with the withdrawal of a member, for instance, because the member has expressly repudiated all its obligations to the Fund, "provision" could be made for that risk even before the effective date of withdrawal of the member.