

**FOR
AGENDA**

EBS/85/104

CONFIDENTIAL

April 25, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Review of the Fund's Income Position
for the Financial Years 1985 and 1986

The attached paper, which provides background material to the discussion on the Administrative Budget scheduled for tomorrow, Friday, April 26, 1985 has also been tentatively scheduled for Executive Board consideration on Wednesday, May 29, 1985.

Mr. Wittich (ext. 8307) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

INTERNATIONAL MONETARY FUND

Review of the Fund's Income Position
for the Financial Years 1985 and 1986

Prepared by the Treasurer's Department

Approved by W. O. Habermeier

April 24, 1985

I. Introduction

The Rules of the Fund provide for a review of the Fund's income position shortly after the end of each financial year and for consideration by the Executive Board of the treatment of any net income or deficit for the year. The Rules also provide that the rate of charge shall be determined at the beginning of each financial year on the basis of the estimated income and expense of the Fund during the year and the target amount of income for the year. In addition, Rule I-10 calls for a review of the working of the formulas used to determine the remuneration coefficient, and Rule T-1(d) provides that the Fund shall review the rate of interest on holdings of SDRs at the conclusion of each financial year. 1/

This paper presents in Section II income and expense of the Fund now expected for the current financial year ending April 30, 1985 and in Section III the preliminary projections of the Fund's income and expense for the financial year ending April 30, 1986. 2/ Treatment of the projected 1985 outcome is discussed in Section IV, and the remuneration coefficient and the SDR interest rate are reviewed in Section V. A summary of Conclusions is set out in Section VI. The review of the Fund's income position for 1985 is based on actual results for the ten months through February 1985 and estimates for the last two months of the financial year. It is intended to issue a supplement to this paper at the end of the financial year should the SDR interest rate have by that time changed more than marginally from the mid-April level. Staff papers on "Factors Relating to Fund Reserves and to Burden Sharing" and on "Special Charges on Overdue Financial Obligations to the Fund", which have an important bearing on the Fund's net income in the coming financial year, are under preparation and will be issued shortly. The staff's conclusions on the Review of the Fund's Income Position will be prepared in the light of these further staff memoranda.

1/ Rules I-6(4), I-10 and T-1(d) are reproduced in the Appendix.

2/ Unless otherwise stated, references in this paper to 1985 and 1986 are to the financial years ending April 30, 1985 and April 30, 1986.

II. Income Position in 1985 and 1986

1. Financial Year 1985

The Fund's income for the year 1985 was initially projected, in the absence of an adjustment in the rate of charge, to be a deficit of SDR 68 million. ^{1/} After the discussion of the outlook for the financial year 1985, the Executive Board adopted a net income target of 3 percent of the Fund's reserves and also decided to deem SDR 22 million of the income earned in 1984 in excess of the target income for that year to be income for 1985 for the purpose of meeting the income target. The remaining net income to be earned in 1985 thus became SDR 10 million. To achieve that net income, the rate of charge was increased with effect from May 1, 1984 to 7.0 percent per annum from the then rate of charge of 6.6 percent per annum (see Table 1). ^{2/}

The Fund's net income was last reviewed by the Executive Board in December 1984 in the course of the midyear review required under Rule I-6(4)(b). ^{3/} The outcome for the six months ended October 31, 1984 was a deficit of SDR 11 million, but in the light of the projections for the remainder of 1985, it was then estimated that the year as a whole would show a net income of SDR 34 million. However, a number of significant uncertainties surrounded the then projected 1985 net income, including particularly the sensitivity to interest rate and other projections and the incidence of overdue payments. In the light of these uncertainties, the Executive Board deferred any decision on a change in the rate of charge until the actual level of net income had been determined at the end of the financial year.

It is now estimated that the result for FY 1985 will be a deficit of SDR 36 million (Table 1). The sharp reversal in the Fund's net income position of SDR 70 million since the midyear review arises mainly from the removal from current income (and placement to deferred income) of charges accrued from members that are overdue for six months or more in discharging obligations to the Fund. These charges are projected to total SDR 56.9 million by the end of April 1985. ^{4/} In the absence of the change to cash accounting for charges from overdue members, the Fund's net income for 1985 would have been projected at

^{1/} See "Review of the Fund's Income Position for the Financial Years 1984 and 1985" (EBS/84/91, 4/24/84).

^{2/} On the basis of the projections made at the time, the rate of charge necessary to reach a net income of SDR 10 million was 6.97 percent. A rate of charge of 7.0 percent for FY 1985 implied a net income of SDR 18 million.

^{3/} See "Mid-Year Review of the Fund's Income Position" (EBS/84/235, 11/19/84).

^{4/} Charges due from Democratic Kampuchea (SDR 0.8 million in 1985) have been shown in deferred income since 1979. Including charges due and accrued from Democratic Kampuchea, deferred income at the end of 1985 is projected to total SDR 64.0 million.

Table 1. Projected Income and Expense
for the Financial Years 1985 and 1986

(In millions of SDRs)

	Actual Ten Months February 28, 1985	1985 Preliminary Projections		Revised Projections	1986 Preliminary Projections <u>3/</u>
		April 1984 <u>1/</u>	November 1984 <u>2/</u>		
1. <u>Operational Income</u>					
a. Periodic charges					
Regular facilities	1,134	1,497	1,382	1,341	1,401
SFF	695	776	865	797	632
Enlarged Access	<u>689</u>	<u>972</u>	<u>904</u>	<u>831</u>	<u>1,156</u>
Total charges	2,518	3,245	3,151	2,969	3,189
b. Interest on SDR holdings	411	459	479	478	286
c. Other income					
Regular facilities	19	32	25	20	19
Enlarged Access	<u>13</u>	<u>24</u>	<u>19</u>	<u>13</u>	<u>23</u>
Total other income	32	56	44	33	42
Total operational income	2,961	3,760	3,674	3,480	3,517
2. <u>Operational Expense</u>					
a. Remuneration	1,437	1,877	1,736	1,721	1,627
b. Interest expense					
SFF	679	758	846	795	627
Enlarged Access <u>4/</u>	<u>638</u>	<u>896</u>	<u>827</u>	<u>769</u>	<u>1,010</u>
Total interest expense	1,317	1,654	1,673	1,564	1,637
Total operational expense	2,754	3,531	3,409	3,285	3,264
3. Net operational income	207	229	265	195	253
4. Administrative expense	<u>185</u>	<u>211</u>	<u>231</u>	<u>231</u>	<u>261</u>
5. Net income (deficit)	22	18	34	-36	-8
Pro memoria					
Deemed Income - 1984	22	22	22	22	

1/ Based on projections in "Review of the Fund's Income Position for the Financial Years 1984 and 1985" (EBS/84/91, 4/24/84) but adjusted for a rate of charge of 7 percent from May 1, 1984.

2/ See "Mid-Year Review of the Fund's Income Position" (EBS/84/235, 11/24/84).

3/ On the basis of the assumptions set out in Table 3.

4/ Less net income from temporary investments held in the Borrowed Resources Suspense Accounts.

about SDR 21 million, i.e., less than projected at midyear, but still somewhat above the net income target for the year and coincidentally very close to the amount projected at the beginning of the year with a rate of charge of 7 percent.

In addition to the shift to nonaccrual, the decrease in net income from the projections made at the time of the midyear review is due largely to a lower use by members of Fund credit than had been estimated and a slightly higher average rate of remuneration reflecting the increase in the remuneration coefficient from February 1, 1985 from 88.33 percent to 90 percent of the SDR interest rate (see Table 2). A detailed comparison of the outcome now projected and the midyear estimates are discussed in the following paragraphs.

(i) Overdue obligations

Overdue obligations of members to the Fund have increased sharply over the past year, from a level of SDR 72.0 million at end-April 1984 to SDR 178.3 million by December 1984; they amounted to SDR 225.2 million by end-March 1985 and may have risen further by the end of the financial year. In the light of these developments, the Executive Board reviewed the matter of overdue obligations and decided that charges by members which are overdue for six months or more in their financial obligations to the Fund are to be placed on a nonaccrual basis, unless these members are current in settling charges as they fall due. ^{1/} Accordingly, no charges will be accrued in the General Resources Account or any other account of the Fund or administered by the Fund from a member that is overdue for six months or more in meeting financial obligations to or under any of the Fund's accounts unless the member remains current in paying charges. Charges from these members are reported as deferred income and will be recognized as income only when they are actually paid. In addition to Democratic Kampuchea, four members are presently overdue for more than six months in meeting financial obligations to the Fund and also are not current in settling charges; income deferred in 1985 from these members (including Democratic Kampuchea) is projected to amount to SDR 57.7 million at the end of the year.

The delays of members in settling their overdue obligations affects the Fund's financial position in ways beyond the nonaccrual of charges. The direct effects on net income reflect interest foregone on the holdings of SDRs that would have been earned had the charges been paid on time, as well as remuneration expense that would not have been incurred (or additional interest earned on SDR holdings) if the overdue repurchases financed from ordinary resources had been paid on time, though income from charges would also have been lower (presuming the

^{1/} See "Overdue Obligations to the Fund--Effect on Income and Treatment in Financial Statements" (EBS/84/231, 11/14/84) and "Overdue Obligations to the Fund--Supplementary Notes to EBS/84/211 and EBS/84/231" (EBS/85/32, 2/5/85). See also EBM/85/40 and EBM/85/41 (3/13/85).

Table 2. Effects on Net Income for 1985
of Differences between Midyear and Revised Projections

(In millions of SDRs)

	Midyear Projections November 1984	Revised Projections	Difference	Explanation of Difference between Original and Revised Projections			Other Nonaccrual of Overdue Charges
				Less than Projected Use of Resources	Lower than Projected Average Interest Rates	Higher than Projected Remuneration Rate	
1. <u>Operational income</u>							
a. Periodic charges	1,382	1,341	-41	-14			-27
b. Interest on SDR holdings	479	478	-1		-1		
c. Charges from borrowed resources net of interest expense	96	64	-32	-13	+11		-30
c. Service charges	<u>44</u>	<u>33</u>	<u>-11</u>	<u>-11</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total	2,001	1,916	-85	-38	+10		-57
2. <u>Operational expense</u>							
Remuneration	<u>1,736</u>	<u>1,721</u>	<u>+15</u>	<u>+18</u>	<u>—</u>	<u>-3 1/</u>	<u>—</u>
3. Net operational income	265	195	-70	-20	+10	-3	-57
4. Administrative expense	<u>231</u>	<u>231</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
5. Net income (deficit)	34	-36	-70	-20	+10	-3	-57

1/ Attributable completely to the increase in the remuneration coefficient on February 1, 1985 from 88.33 percent to 90.00 percent of the SDR rate of interest. (The total effect of the increase is SDR 7 million).

repurchase had been made). ^{1/} However, to the extent that borrowing would have been repaid from the proceeds of the repurchases rather than from the Fund's ordinary resources, the Fund's income would have been reduced by an amount greater than the remuneration expense on the ordinary resources used to repay the borrowing. The net negative effect on the Fund's net income is projected to amount to SDR 4.3 million for the full financial year. Its composition is as follows (amounts in millions of SDRs):

	<u>1985</u>
Reduced interest on SDR holdings	4.3
Excess of remuneration over reduction in charges--ordinary resources	0.6
Excess of charges over remuneration on repayment of borrowing with ordinary resources	<u>-0.6</u>
Net	4.3

(ii) Use of reserve tranche positions and of Fund credit

Midyear income estimates were based on the assumption that members' use of unremunerated reserve tranche positions, on which the Fund does not earn income but which increases remuneration expense (or reduces income from SDR holdings), would be in the order of SDR 400 million. Actual purchases made so far suggest use of unremunerated reserve tranche positions is unlikely to exceed SDR 220 million in 1985 (Table 3).

Members' use of Fund credit was estimated at the time of the mid-year review to be in the order of SDR 8.9 billion, of which SDR 5.0 billion were to be financed from ordinary resources and SDR 3.9 billion from borrowed resources. It is now projected that purchases will be SDR 6.3 billion in 1985 mainly due to the delay of some large drawings scheduled during the last half of the financial year.

(iii) Interest rates

Although interest rates fluctuated markedly, average rates did not diverge markedly from those projected in November (Table 3 and Appendix Chart 1). Movements in interest rates did, however, have an

^{1/} Indirect effects include the potential impact on the Fund's ability to attract resources and hence to support balance of payments adjustment programs of member countries, and similar effects.

Table 3. Assumptions Underlying the Projections
for Financial Years 1985 and 1986

(In millions of SDRs)

	Actual Ten Months February 28, 1985	1985 Preliminary Projections		Revised Projections	1986 Preliminary Projections
		April 1984 <u>1/</u>	November 1984 <u>2/</u>		
A. Ordinary Resources					
1. Purchases					
Unremunerated reserve tranche <u>3/</u>	204	500	400	220	400
Credit tranches	2,113	4,520	3,145	2,250	2,870
Compensatory financing and Buffer Stock	<u>1,153</u>	<u>1,780</u>	<u>1,500</u>	<u>1,260</u>	<u>840</u>
Total	3,470	6,800	5,045	3,730	4,110
2. Repurchases other than SFF and Enlarged Access	1,771	2,005	2,075	2,100	2,720
3. Average SDR holdings	5,573	5,100	5,430	5,425	3,530
B. Borrowed Resources					
1. SFF:					
Repayments of borrowing	572	675	675	675	1,200
Repurchases	522	640	640	620	1,160
2. Enlarged Access:					
Purchases	2,519	4,880	3,885	2,590	4,655
Repayments of borrowing	1,064	1,190	1,065	1,075	430
Repurchases	43	45	45	45	305
C. Interest Rates					
1. Average SDR interest rate (percent)	8.86	9.00	8.83	8.81	8.10
2. Average rate of remuneration (percent)	7.81	7.95	7.76	7.77	7.42
3. Average rate of charge (percent)	7.00	7.00	7.00	7.00	
4. Average SFF interest rate (percent)	12.37	11.50	12.86	12.07	11.12
5. Average net cost of borrowing under enlarged access policy (percent)	10.56	10.44	10.85	10.49	10.18
D. Income Deferred	1	1	1	58 <u>4/</u>	58 <u>5/</u>

1/ See "Review of the Fund's Income Position for the Financial Years 1984 and 1985" (EBS/84/91, 4/24/84).

2/ See "Mid-Year Review of the Fund's Income Position" (EBS/84/235, 11/19/84)

3/ Only purchases in the unremunerated reserve tranche affect the Fund's income position. Purchases in the remunerated reserve tranche represent a shift of a remunerated position from the purchasing member to the members whose currencies are sold by the Fund and have no effect on the Fund's income position. If SDRs are used by the Fund to finance such purchases there would be a net fall in income because the rate of remuneration (and hence remuneration expense) is lower than the SDR rate of interest (and hence income foregone).

4/ Assuming that no repurchases will be made before April 30, 1985 by the five members for which charges at present are recorded as deferred income.

5/ The projection of income deferred in 1986 is discussed on pages 9-11.

effect on the remuneration coefficient and thus on the Fund's income. 1/ By end-January 1985, the SDR interest rate had declined to 7.92 percent or to 0.99 percentage point below the rate at April 30, 1984, which determines the interest rate-related adjustment of the remuneration coefficient. In accordance with Rule I-10(b)(1)(ii), the coefficient was increased from 88.33 percent to 90 percent of the SDR interest rate as from February 1, 1985, resulting in additional remuneration cost of about SDR 7 million. 2/

III. Projections for Financial Year 1986

1. Basis for the projections

As indicated in the review of the Fund's liquidity position, commitments under new arrangements are projected to be moderate in the year ahead in relation to those of the past several years. Nevertheless, net use of Fund credit is projected to rise in comparison to last year, in part reflecting delayed purchases under existing arrangements. 3/ Total purchases in 1986 are estimated to be in the order of SDR 8.8 billion, of which about SDR 4.1 billion would be financed from the Fund's ordinary resources, and the remainder from borrowed resources (Table 3 and Appendix Chart 2). These estimates take into account the projections of commitments and disbursements over the next twelve months and are based on the present Fund policies and practices, including accounting practices such as the practice of writing off capital expenditures in the year they are made 4/ and incorporate the following projections and hypotheses: 5/

(i) purchases in the unremunerated reserve tranche are projected at SDR 400 million;

(ii) purchases under existing or anticipated stand-by and extended arrangements will amount to SDR 2.9 billion and will be made in accordance with agreed (or estimated) phasing;

(iii) compensatory financing and buffer stock purchases will amount to SDR 0.8 billion;

1/ The weekly SDR interest rate since May 1, 1984 is shown in Appendix Table 3.

2/ The determination of the remuneration coefficient is discussed further in Section V below.

3/ See "The Fund's Liquidity and Financing Needs" (EBS/85/56, 3/7/85).

4/ As indicated in the Managing Director's Work Program (Buff 84/167), accounting for capital expenditures is presently being reviewed by the staff and a paper on this matter will be issued shortly.

5/ These projections, the impact on outstanding use of Fund resources, and the effect on projected income for 1986 are summarized in Tables 1 and 3 above, and in Appendix Table 1.

(iv) repurchases of credit financed by borrowing (SDR 1.5 billion) and repayments to lenders will be made in the amounts and on the dates scheduled;

(v) repurchases of purchases financed by ordinary resources (SDR 2.7 billion) will be made in the amounts and on the dates scheduled;

(vi) repayments of borrowings will total SDR 1,630 million of which SDR 165 million will be made with ordinary resources;

(vii) the Fund's holdings of SDRs will be reduced to a level of about SDR 2.5 billion by end-April 1986 and are estimated to average about SDR 3.5 billion for the year as a whole;

(viii) the SDR interest rate is projected to continue unchanged at the present level (rounded to the nearest one-tenth of one percent) and thus average 8.1 percent and the rate of remuneration, at 91.66 percent of the SDR interest rate, is estimated to average 7.42 percent;

(ix) there will be a net increase, as discussed further in the following section, of deferred charges of SDR 58 million, representing the balance between discharge of presently deferred income and additions to deferred income of charges from members being more than six months late in meeting payments to the Fund.

Based on these projections and assumptions, average income producing balances (currency holdings subject to charges plus SDR holdings) are estimated to decline slightly from SDR 25.0 billion in 1985 to SDR 23.9 billion in 1986, interest costing balances are expected to fall, on average, from SDR 22.1 billion to SDR 21.9 billion, and the average balance of outstanding borrowing is expected to rise to SDR 15.6 billion (see Appendix Table 1).

2. Deferred income

The recent decision not to include in income charges that have accrued or are due from members which are overdue for six months or more in meeting payments to the Fund (including payments to the Trust Fund, the Administered Accounts, or in the SDR Account), is an important *new element that needs to be taken into account in making income projections for the purpose of determining the rate of charge on the use of Fund resources during the next financial year.*

In order to project the likely amount of income that might be deferred during the year, it would be necessary to form a judgment on the timing of the payment of charges from members with protracted overdue obligations that are presently recognized as income only when payment is actually received. A judgment would also be necessary as to the members from which income might need to be deferred during the year, and when this might occur in 1986. However, any projection based

on such a judgment could be read as calling into question the good faith of these member countries to settle their obligations promptly or on time.

Various approaches could be considered in order to avoid any such implication. For example, the income projections could be based on an assumption that all deferred income would be received before the end of 1985 and no deferrals would arise during the next financial year. As a variant, it might be projected that the outstanding amount of deferred income would not change, which would be tantamount to assuming that any payment of presently deferred income would be offset by new deferrals of the same amount, either by the same or by other members. In either case, the net income projected for 1986 would not be reduced because of the change to nonaccrual accounting.

Another approach would be to project--in analogy to the projection of the SDR interest rate--that no change would occur in the present accounting status applicable to member countries. Accordingly, income projections for 1986 would not include any charges accrued or payable during the year by those members that currently are in arrears to the Fund for six months or more; charges from these members would be reported as deferred income. At the same time, it would be assumed that no additional member would have to be put on a nonaccrual basis because it had fallen overdue for more than six months in payments to the Fund. On these assumptions, the addition to deferred income in 1986 would amount to SDR 63.6 million, equivalent to 0.31 percentage point in the rate of charge. As indicated above, this approach seems to carry an unwarranted implication of an expectation that members presently overdue for six months or more to the Fund would continue to fail meeting their financial obligations, which cannot but reflect badly on these members.

A third, and preferred, approach would be to develop an indicator of the amount of income that might be newly deferred during the subsequent year. In order not to carry implications about payments by particular member countries, the indicator might be based on what would have been the Fund's experience in the aggregate with the deferral of income from those members that are in arrears for six months or more, if such a policy of nonaccrual had been in effect earlier. For example, such an indicator could rely on recent experience with the deferral of income and with the payment of deferred income if that experience showed some pattern or indicated some ratio, e.g. to the total of charges, that could be applied. While this method would give considerable weight to the Fund's limited experience, it would avoid the difficulties discussed above of projecting deferred income on the basis of those members that are in arrears for six months or more and its application over a number of periods might lead over time to an accumulation of experience with the applicable ratios. Table 4 shows the total of charges that would have been deferred during the last four quarters under a nonaccrual policy, the amounts received (or restored to accrued income), net deferrals, as well as net deferred income as a percent of total charges due during the quarter. The table shows that while the ratio of net

deferral of income to total charges fluctuated considerably from quarter to quarter, the average ratio (expressed in percent) for the year as a whole was 1.65 percent. If this ratio were applied to projected periodic charges of SDR 3,247 million for 1986, it would suggest net new deferral

Table 4. Hypothetical Deferred Charges, 1985 ^{1/}

(In millions of SDRs)

Quarter ended	Charges deferred	Payments received	Net deferred during quarter	Total charges	Net deferred as percent of total charges
July 1984	3.97	0.72	3.25	755.66	0.43
October 1984	2.72	6.33	-3.61	771.09	-0.46
January 1985	55.56	3.16	52.40	758.59	6.91
April 1985	<u>15.54</u>	<u>17.65</u>	<u>-2.11</u>	<u>741.06</u>	-0.28
FY 1985	77.79	27.86	49.93	3,026.40	1.65

^{1/} Assuming the nonaccrual policy adopted in March 1985 had been in effect during the whole of FY 1985.

of charges of about SDR 54 million. An alternative method would be to project that the aggregate of deferred income during the subsequent year would equal the income deferred during the year just ended, i.e., in the present case SDR 58 million. In view of the possibility that the net deferral coefficient reflects short-term developments that may be coincidental rather than reflecting a genuine improvement in the outlook for the coming year, there may be advantage in taking both these possible methods into account, and in order to safeguard the Fund's financial position the staff would suggest to take the higher of the results of the two formulas. Accordingly, income projected for 1986 on the basis that charges from all members would be accrued and paid when due has been reduced by SDR 58 million. In view of the limited experience with the nonaccrual of charges, it is the staff's view that for any reestimation of net income for the midyear review, the ratio of net new deferral should be reestimated by the same method, i.e., as the higher of the amount yielded by applying net deferral ratio over the last 12 months to projected charges for the next six months or the amount deferred during the preceding 12 months (on an annualized basis.)

3. The rate of charge for 1986

The projected increase in the use of Fund resources in combination with the projected increase in remuneration would result in a deterioration of the Fund's income position in 1986. With the projections detailed in the preceding sections, the Fund's total expenditures at SDR 3,525 million would exceed income (SDR 3,517 million) by an estimated SDR 8 million if the present rate of charge on the use of the Fund's ordinary resources continued unchanged at 7 percent.

In view of the projected development in the Fund's income and expenditures, the Executive Board will need to consider an increase in the rate of charge in order to avoid a deficit and to arrive at an appropriate target net income. 1/

A net income target for 1986 set under Rule I-6(4) at 3 percent of reserves would be SDR 31.1 million, which would require an increase in the rate of charge to 7.19 percent. If the rate of charge remained unchanged at 7 percent and the projections presented above turned out to be reasonably accurate, the Fund at the time of the midyear review would have realized net income in the order of SDR 1 million. The rate of charge required from November 1, 1985 to reverse the deficit experienced in the first half of the year and to achieve the net income target of 3 percent of reserves specified by Rule I-6(4)(a) amounts to 7.38 percent.

Three issues may be seen to arise with net income target and the current aim of increasing reserves by 3 percent over their level at the beginning of the year: (i) the projections do not take into account any income that might be received from special charges on overdue obligations which the Executive Board has requested the staff to review. Possible ways to implement such charges, their impact on the Fund's financial position and possibly on the reserve target are discussed in separate papers to be issued shortly; (ii) the target amount is lower than the 1985 net income target (including deemed income) of SDR 32 million because the deficit now expected for 1985 will reduce the Fund's reserves from SDR 1,074 million to SDR 1,038 million and the target is thus calculated from a lower base. This raises the question whether the decline in the Fund's reserves should be recovered through a higher net income target; and (iii) whether on more general grounds, such as uncertainty as to the receipt of income, the net income target should be increased beyond the 3 percent incorporated in Rule I-6(4)(a).

1/ The rates of charge discussed in the following paragraphs to achieve a specified net income target are considered illustrative, as they are influenced by interest rate developments that occur before Board consideration of the Fund's income position. As indicated earlier, it is intended to issue a supplement to the present paper if the SDR interest rate will by the end of the current financial year have changed more than marginally from the present rate.

It will be recalled that in its recent discussion of the effects of overdue obligations on the Fund's financial position, a number of Executive Directors considered it prudent, in view of the increased amount of outstanding repurchase obligations that had not been discharged when due and the lengthening delays in discharging these overdue obligations, for the Fund to aim at larger net income than the target of 3 percent of reserves presently applicable--unless the Executive Board decided otherwise--under Rule I-6(4)(a). ^{1/} Some Executive Directors felt an increase in the net income target of somewhat less than doubling, as in alternative (b) of the Managing Director's opening statement (Buff 85/47, 3/8/85), would be sufficient in the light of the accounting changes adopted by the Executive Board, say to 5 percent, while others favored a somewhat faster accretion of reserves of, say 7-8 percent. Some other Executive Directors emphasized that these overdue obligations would be discharged as soon as the overdue members, which were in very difficult economic and balance of payments positions, found it possible to do so; they therefore felt that no increase in the income target was necessary or called for in these circumstances. In view of the wide divergency of views, the Executive Board agreed to postpone a decision on this matter and requested the staff to prepare some material on the adequacy of the Fund's reserves and on the factors relevant in a judgment on the relative contributions made by members towards the operation of the Fund and the meeting of its purposes. These factors are reviewed in a staff memorandum "Factors Relating to Fund Reserves and to Burden Sharing" to be issued shortly.

Pending consideration of these issues, no increase in the reserve target has been assumed. However, it may be noted that a target rate of growth of Fund reserves of 5 percent would require a net income target of SDR 51.9 million and call--with the present SDR interest rate of 8.1 percent and rate of remuneration of 7.42 percent--for a rate of charge of 7.29 percent; a net income target of 8 percent of reserves would translate into an income target of SDR 83.0 million which, in the light of the projections discussed earlier in this memorandum, would require a rate of charge of 7.45 percent. More generally, based on the average amount of credit projected to be outstanding in FY 1986, each change of one percentage point in the reserve target implies a change of SDR 10.38 million in the net income target and would increase or decrease the rate of charge required to meet the target, on an annual basis, by about 0.05 percentage point.

4. The impact of deviations from the projections for major variables

Following the sharp expansion of the Fund's lending activity since the late 1970s and the concomitant increase in remunerated positions, approximately one half of the Fund's operational cost is now represented by remuneration payments. Moreover, operational expenditures are very large in relation to the net income target which, at SDR 10 million

^{1/} EBM/85/40 and EBM/85/41 (3/15/85).

in 1985 was less than one third of 1 percent of these expenditures. ^{1/} As operational expenditures largely reflect the cost of borrowing and of remuneration, market rates of interest have a substantial impact on the Fund's net income. As can be seen from Table 5, the effect of a change in market interest rates, and hence in the SDR interest rate and in the rate of remuneration, easily overwhelms the Fund's net income target. For example, an increase in the average annual SDR interest rate from the present level of about 8.1 percent to, say, 8.50 percent would, with the projected use of Fund resources and at the present rate of charge of 7 percent, increase the Fund's deficit from SDR 8 million to SDR 77 million, or by more than twice the net income target of 3 percent of reserves.

Deviations in the amount or timing of purchases from the assumptions underlying the projections also affect income though except for purchases in the unremunerated reserve tranche, not very sharply. A use of the unremunerated reserve tranche decreases the availability of interest-free resources and gives rise to remuneration payments (or reduces the earnings from SDR holdings), but does not result in additional income as reserve tranche use is not subject to charges. It thus affects the income position quite strongly; a level of such purchases of SDR 800 million, which is twice the amount of the projection but which could well materialize if one or two of the countries presently included in the operational budget were to make use of their Fund-related reserve assets, would (again at the present rate of remuneration) increase the deficit by about SDR 15 million.

Purchases in the credit tranches not only result in additional remuneration payments, but also increase the income from charges and give rise to service charges. Any deviation from projected levels, therefore has only a small effect on the income position. At the present rates of charge and remuneration, purchases higher than present projections would marginally increase the deficit if made early in the year, but decrease if they occur later in the year because then the income from the service charge exceeds the excess of cost of resources above charges.

An additional element of uncertainty regarding the income projections relates to the recent change to accounting on a cash basis for charges from members that are more than six months late in meeting financial obligations to the Fund and also are overdue in paying charges. Actual experience may differ significantly from the projections that about 2 percent of projected charges might need to be added to deferred income in 1986.

^{1/} As mentioned earlier, the net income target of 3 percent of reserves was partially met by "deeming".

Table 5. Effect of Different Assumptions
on the Fund's Income Position and the Rate of Charge
Financial Year 1986

(In millions of SDRs)

	Average Annual SDR Rate of Interest ^{1/} (In percent)							
	7.25 ^{2/}	7.50 ^{3/}	7.75	8.00	8.10	8.25	8.50	8.75
Changes in projected purchases in the unremunerated reserve tranche and in the credit tranches								
1. As projected in Table 2								
Net income ^{4/}	136	109	51	9	-8	-34	-77	-120
Rate of charge necessary to produce net income of:								
3 percent of reserves	6.48	6.62	6.90	7.11	7.19	7.32	7.53	7.74
5 percent of reserves	6.59	6.72	7.00	7.21	7.29	7.42	7.63	7.84
8 percent of reserves	6.74	6.87	7.15	7.36	7.45	7.57	7.78	7.99
2. Purchases in the unremunerated reserve tranche, higher by SDR 400 million								
Net income ^{4/}	122	95	36	-6	-23	-50	-93	-134
Rate of charge necessary to produce net income of:								
3 percent of reserves	6.55	6.68	6.97	7.18	7.26	7.40	7.61	7.81
5 percent of reserves	6.66	6.79	7.08	7.29	7.37	7.50	7.71	7.91
8 percent of reserves	6.81	6.94	7.23	7.44	7.52	7.65	7.86	8.06
3. Purchases in the unremunerated reserve tranche, lower by SDR 100 million								
Net income ^{4/}	140	113	54	13	-4	-30	-73	-116
Rate of charge necessary to produce net income of:								
3 percent of reserves	6.47	6.60	6.89	7.09	7.17	7.30	7.51	7.72
5 percent of reserves	6.57	6.70	6.99	7.19	7.27	7.40	7.61	7.82
8 percent of reserves	6.72	6.85	7.14	7.34	7.43	7.55	7.76	7.97
4. Credit tranche purchases, higher by SDR 1,000 million								
Net income ^{4/}	142	114	56	13	-5	-32	-76	-120
Rate of charge necessary to produce net income of:								
3 percent of reserves	6.46	6.59	6.88	7.09	7.18	7.31	7.52	7.74
5 percent reserves	6.56	6.69	6.98	7.19	7.28	7.41	7.63	7.84
8 percent of reserves	6.71	6.85	7.13	7.34	7.43	7.56	7.78	7.99
5. Credit tranche purchases, lower by SDR 1,000 million								
Net income ^{4/}	130	104	46	6	-11	-37	-79	-120
Rate of charge necessary to produce net income of:								
3 percent of reserves	6.51	6.64	6.92	7.12	7.21	7.33	7.54	7.74
5 percent of reserves	6.62	6.74	7.03	7.23	7.31	7.44	7.64	7.84
8 percent of reserves	7.77	6.90	7.18	7.38	7.46	7.59	7.79	7.99

^{1/} Assumes SDR rate of interest to be at 8.10 percent on April 30, 1985.

^{2/} An SDR rate of interest of 7.25 percent would produce a remuneration coefficient of 94 percent rather than the rate of 91.66 which would be in effect for the SDR rate of interest from 7.75 percent to 8.75 percent.

^{3/} An SDR rate of interest of 7.50 percent would produce a remuneration coefficient of 93 percent rather than the rate of 91.66 which would be in effect for the SDR rate of interest from 7.75 to 8.75 percent.

^{4/} Net income at the present rate of charge (7.00 percent).

IV. Disposition of 1985 Deficit and Determination
of the Rate of Charge for 1986

The estimated deficit of the Fund for 1985 of SDR 36 million will be charged to the Special Reserve in accordance with Executive Board Decision No. 708-(57/57), 1/ reducing total reserves to SDR 1,038 million. The development in reserves since 1977, when the Fund last incurred a deficit, is shown in Table 6 below:

Table 6. Changes in Reserves, 1977-85

(In millions of SDRs)

	<u>Reserves</u>			Net income as percent of reserves at beginning of year
	<u>Special</u>	<u>General</u>	<u>Total</u>	
Balance April 30, 1976	339.1	365.6	704.7	
Net income 1977	-18.2		-18.2	-2.58
Net income 1978	27.5		27.5	4.01
Net income 1979	46.1		46.1	6.46
Net income 1980	3.1		3.1	0.41
Net income 1981	80.1		80.1	10.50
Net income 1982	92.0		92.0	10.90
Net income 1983	65.4		65.4	7.00
Net income 1984	73.1		73.1	7.30
Net income 1985 (est.)	-36		-36	-3.35
Totals	672.2	365.6	1,037.8	4.39

V. Review of the Rate of Remuneration and the SDR Interest Rate

The Executive Board in December 1983 reviewed the determination of the rate of remuneration and decided that the remuneration rate in relation to the SDR interest rate (the "remuneration coefficient") should be raised, as a minimum, from the then prevailing level of 85 percent by 3.33 percentage points at the beginning of each of the following three financial years. Further (reversible) increases not exceeding a band of 2.5 percent above this minimum level would depend on differences between the SDR interest rate on the day before each

1/ "... B. The income of the investment earned after October 31, 1957 shall be placed to a Special Reserve, and any administrative deficit for any fiscal year of the Fund shall be written off first against this reserve."

quarter in relation to the rate in effect at April 30, 1984. 1/ The decision also calls for a review of the determination of the remuneration coefficient on the occasion of the annual review of the Fund's financial position. 2/

In accordance with that decision, the remuneration coefficient was raised to 88.33 percent on May 1, 1984. The SDR interest rate increased from 8.91 percent at April 31, 1984 to 9.67 percent early in August 1984 and remained above the end-April rate until late in October 1984 (see Appendix Table 2). Accordingly, no further increase of the remuneration coefficient occurred in the three subsequent quarters. However, after a marked decline in the last quarter of (calendar) 1984 and in January 1985, the SDR interest rate reached a low point of 7.79 percent during the week of December 31, 1984 and was 7.92 percent in the week of January 28, 1985. Accordingly, the remuneration coefficient was increased to 90 percent for the quarter beginning February 1, 1985. 3/

As has already been mentioned, the remuneration coefficient will be increased at least to 91.66 percent starting May 1, 1985. For it to rise beyond that level, the SDR interest rate would have to decline to 7.74 percent or lower during the week that begins before any quarter of the financial year 1986. The maximum the coefficient could reach during any quarter in 1986 is 94.16 percent, for which the SDR interest rate would have to be below 7.25 percent on the last day before any quarter. Any increase in the coefficient beyond 91.66 percent would be reversed if the SDR interest rate on the last day before any subsequent quarter were above the level that gave rise to the increase.

The present rate of charge and the rates of charge necessary to achieve the present net income target or those mentioned at EBM/85/40 and EBM/85/41 as discussed above, remain below the projected SDR interest rate, and no change in the procedure laid out in Rule I-10 for the determination of the remuneration coefficient is suggested at the present time.

In addition to the remuneration coefficient, the Fund at the end of each financial year also has to review the SDR interest rate. 4/ No change is proposed in the SDR rate of interest.

1/ The exact procedures for determining the remuneration coefficient each quarter are spelled out in Rule I-10(b). Rule I-10 is reproduced in the Appendix.

2/ Rule I-10(c).

3/ See "The Remuneration Coefficient for the Financial Quarter Beginning February 1, 1985" (SM/85/36, 1/31/85).

4/ Section (d) of Rule T-1 reads: "The Fund will review the rate of interest on holdings of SDRs at the conclusion of each financial year."

VI. Preliminary Conclusions

1. The Fund's income position for FY 1985 is now expected, after the exclusion from accrued charges of SDR 58 million accrued from members overdue for six months or more in meeting financial obligations to the Fund, to show a deficit of SDR 36 million instead of a surplus of SDR 34 million projected at the time of the midyear review of the Fund's income position. In accordance with Executive Board Decision No. 708-(57/57) (11/27/57), the deficit will be charged to Special Reserves, which will reduce Special Reserves to SDR 672 million and total reserves to SDR 1,038 million.
2. For FY 1986, a deficit in the order of SDR 8 million is projected on the basis of continuation of the rate of charge on the use of the Fund's ordinary resources of 7 percent, continuation of the SDR rate of interest at the present level of about 8.1 percent, an increase in the remuneration coefficient of 91.66 percent on May 1, 1985 but no further change in the coefficient thereafter, and the estimated use of Fund resources. The projected gross income and gross expenditures are, however, sensitive to even slight variations in some of these assumptions, particularly to changes in market interest rates.
3. Actual income in 1986 will be affected by any charges that would have to be reported as deferred income because a member or members are more than six months late in meeting payments to the Fund and by any payment of such overdue charges or possibly of overdue repurchases. In the absence of past experience on the basis of which it might be reasonable to project the timeliness of members in discharging due or overdue obligations, the staff has projected deferred income in 1986 as the higher of the amount yielded by applying to projected charges the average net deferral rate in 1985 and net deferrals in 1985, resulting in further net nonaccruals of SDR 58 million.
4. The Executive Board has requested a staff paper on special charges that might be levied on overdue obligations, which is to be issued shortly. The conclusions reached by the Executive Board in the discussion of that paper may be expected to be taken into account in the consideration of the Fund's income position and the rate of charge for 1986.
5. In their discussion of the effect of overdue payments on the Fund's financial position at EBM/85/41, Executive Directors agreed to retain unchanged the net income target of 3 percent of reserves, but would review this matter in connection with the annual review of the Fund's income position and the determination of the rate of charge for 1986 on the basis of a staff paper which it is intended to issue shortly.
6. Apart from a new income target for subsequent years, the Executive Board when reviewing the net income target for 1986 may also wish to consider whether and to what extent it would be desirable to reverse the decrease in the Fund's reserves caused by the deficit in FY 1985.

7. The staff will issue in mid-May a supplement to the present paper on the basis of information at the end of the financial year, which will serve as a basis for making recommendations for the consideration of the Executive Board of steps to deal with the Fund's financial position for 1986.

APPENDIX

Table 1. Projections of Average Daily Balances and Rates of Periodic Charges, SDR Interest, Remuneration, and Interest on Borrowing Financial Years 1985 and 1986

(In millions of SDRs)

	Actual Ten Months February 28, 1985	1985 Preliminary Projections		Revised Projections	1986 Preliminary Projections
		April 1984 1/	November 1984 2/		
A. Ordinary Resources and GAB Borrowing					
1. Balances subject to periodic charges	19,450	21,380	19,750	19,540	20,400
Average rate of charge	7.00	7.00	7.00	7.00	7.00
2. Holdings of SDRs in the General Resources Account	5,570	5,100	5,430	5,425	3,530
Average interest rate	8.86	9.00	8.83	8.81	8.10
3. Revenue-producing balances	25,020	26,480	25,180	24,965	23,930
Weighted average rate of revenue	7.41	7.39	7.39	7.40	7.16
4. Remunerated positions	22,105	23,610	22,370	22,135	21,940
Average rate of remuneration	7.81	7.95	7.76	7.77	7.42
5. Expense-producing balances	22,105	23,610	22,370	22,135	21,940
Weighted average rate of revenue	7.81	7.95	7.76	7.78	7.42
6. Pro memoria					
Margin between rate of charge and the average rate of remuneration	-0.81	-0.95	-0.76	-0.78	-0.42
B. Borrowed Resources					
1. Balances subject to periodic charges					
SFF	6,690	6,690	6,690	6,630	5,710
Enlarged Access	7,690	9,140	8,180	7,880	11,260
Total	14,380	15,830	14,870	14,510	16,970
Average rate of charge					
SFF	12.47	11.71	13.08	12.40	11.39
Enlarged Access	10.76	10.64	11.01	10.69	10.58
Combined	11.56	11.10	11.96	11.43	10.79
2. Borrowings					
SFF	6,590	6,590	6,580	6,590	5,635
Enlarged Access 3/	7,523	8,585	7,730	7,445	9,955
Total	14,113	15,175	14,310	14,035	15,590
Average rate of interest					
SFF	12.37	11.50	12.86	12.07	11.12
Enlarged Access 4/	10.56	10.44	10.85	10.49	10.18
Combined	11.41	10.90	11.77	11.24	10.52
3. Pro memoria					
Excess of average balances subject to periodic charges over average borrowings					
SFF	100	20	30	60	75
Enlarged Access	310	555	560	550	1,305
Total	410	575	590	590	1,380

1/ See "Review of the Fund's Income Position for the Financial Years 1984 and 1985" (EBS/84/91, 4/24/84).

2/ See "Review of the Fund's Income Position" (EBS/84/235, 11/21/84).

3/ Balances held in the Borrowed Resources Suspense Account averaged SDR 143 million during the ten month period ended February 28, 1985 and are estimated to average SDR 125 million during financial year 1985. The estimates for 1986 assume no balances in the Borrowed Resources Suspense Account.

4/ Net cost of borrowing after deducting net income from investments.

Table 2. SDR Interest Rate and Rate of Remuneration
Weekly Changes FY 1985

Week Beginning	SDR Interest Rate	Rate of Remuneration
<u>1984</u>		
May 1 ^{1/}	8.91	7.87
May 7	9.03	7.98
May 14	9.20	8.13
May 21	9.07	8.01
May 28	8.99	7.94
June 4	9.08	8.02
June 11	9.10	8.04
June 18	9.11	8.05
June 25	9.09	8.03
July 2	9.14	8.07
July 9	9.24	8.16
July 16	9.35	8.26
July 23	9.48	8.37
July 30	9.56	8.44
August 6	9.67	8.54
August 13	9.50	8.39
August 20	9.39	8.29
August 27	9.47	8.36
September 3	9.56	8.44
September 10	9.54	8.43
September 17	9.41	8.31
September 24	9.36	8.27
October 1	9.33	8.24
October 8	9.30	8.21
October 15	9.16	8.09
October 22	8.97	7.92
October 29	8.78	7.76
November 5	8.55	7.55
November 12	8.34	7.37
November 19	8.30	7.33
November 26	8.21	7.25
December 3	8.21	7.25
December 10	8.15	7.20
December 17	8.02	7.08
December 24	7.81	6.90
December 31	7.79	6.88
<u>1985</u>		
January 7	7.82	6.91
January 14	7.83	6.92
January 21	7.96	7.03
January 28	7.92	7.00
February 1 ^{2/}	7.92	7.13
February 4	8.30	7.47
February 11	8.43	7.59
February 18	8.45	7.61
February 25	8.60	7.74
March 4	8.78	7.90
March 11	8.77	7.89
March 18	8.65	7.79
March 25	8.64	7.78
April 1	8.41	7.57
April 8	8.38	7.54
April 15	8.27	7.44
April 22	8.07	7.26

^{1/} Week began April 30, 1984. However, first day of the financial year was May 1, 1984 at which time the remuneration coefficient increased from 85 percent to 88.33 percent of the SDR interest rate.

^{2/} Remuneration coefficient increased from 88.33 percent to 90 percent of the SDR interest rate as from the first day of the last financial quarter of FY 1985. February 1, 1985 was a Friday.

APPENDIX

Table 3. Factors Explaining the Difference Between
the Rate of Remuneration and the Rate of Charge Under Rule I-6(4)
for 1985 and 1986

	1985 <u>1/</u>	Present Rate	1986 Illustrative Rates Net Income Target of: (Percent of Reserves)		
			3	5	8
1. Rate of remuneration	7.95	7.42	7.42	7.42	7.42
2. Rate of charge under Rule I-6(4):	<u>7.00</u>	<u>7.00</u>	<u>7.19</u>	<u>7.29</u>	<u>7.45</u>
3. Difference	0.95	0.42	0.23	0.13	-0.03
Explained by:					
Rate of remuneration x $\frac{\text{Interest-free resources}}{\text{Use of Fund credit}}$	1.27	1.22	1.22	1.22	1.22
Difference between SDR interest rate and rate of remuneration x $\frac{\text{SDR holdings}}{\text{Use of Fund credit}}$	0.25	0.12	0.12	0.12	0.12
$\frac{\text{Income from service charges}}{\text{Use of Fund credit}}$ x 100	0.26	0.21	0.21	0.21	0.21
$\frac{\text{Income from margins on SFF and Enlarged Access}}{\text{Use of Fund credit}}$ <u>2/</u> x 100	0.24	0.39	0.39	0.39	0.39
$\frac{\text{Deficit}}{\text{Use of Fund credit}}$ x 100	--	0.04	--	--	--
Less:					
$\frac{\text{Charges deferred}}{\text{Use of Fund credit}}$ x 100	--	-0.28	-0.28	-0.28	-0.28
$\frac{\text{Administrative expense}}{\text{Use of Fund credit}}$ x 100	-0.99	-1.28	-1.28	-1.28	-1.28
$\frac{\text{Target income}}{\text{Use of Fund credit}}$ x 100	<u>-0.08</u>	<u>--</u>	<u>-0.15</u>	<u>-0.25</u>	<u>-0.41</u>
	0.95	0.42	0.23	0.13	-0.03

1/ Based on original estimates made in April 1984. See "Review of the Fund's Income Position for the Financial Years 1984 and 1985," EBS/84/91 (4/24/84).

2/ Income from margins, net of remuneration expense resulting from the substitution of ordinary for borrowed resources.

Table 4. Projections of Sources and Uses of Resources
for 1985 and 1986 1/

(In millions of SDRs)

	1986	1985
<u>Sources</u>		
Interest-free		
Sales of gold	2,975	2,975
Subscription payments above the "norms" for remuneration <u>2/</u>	785	785
Reserves	1,035	1,070
Excess of sundry liabilities over sundry assets	85	-120
	4,880	4,710
Less - Use of unremunerated reserve tranche	1,510	1,280
	3,370	3,430
Interest-costing		
Borrowings <u>3/</u>	15,590	13,910
Remunerated positions	21,940	22,135
	37,530	36,045
Total Sources	40,900	39,475
<u>Uses</u>		
Purchases subject to charges financed with:		
Ordinary resources	20,400	19,540
Borrowed resources	16,970	14,510
SDR holdings <u>4/</u>	3,530	5,425
Total Uses	40,900	39,475
<u>1/</u> Estimates of average daily balances.		
<u>2/</u> Excluding payments in gold in past years of up to 25 percent of quota as such payments added to the Fund's gold holdings.		
<u>3/</u> Net of borrowed resources held in suspense accounts.		
<u>4/</u> SDR holdings are a use in the sense that they yield interest income.		



CHART 1
 RATE OF CHARGE, SDR INTEREST RATE AND RATE OF REMUNERATION
 (In per cent per annum)

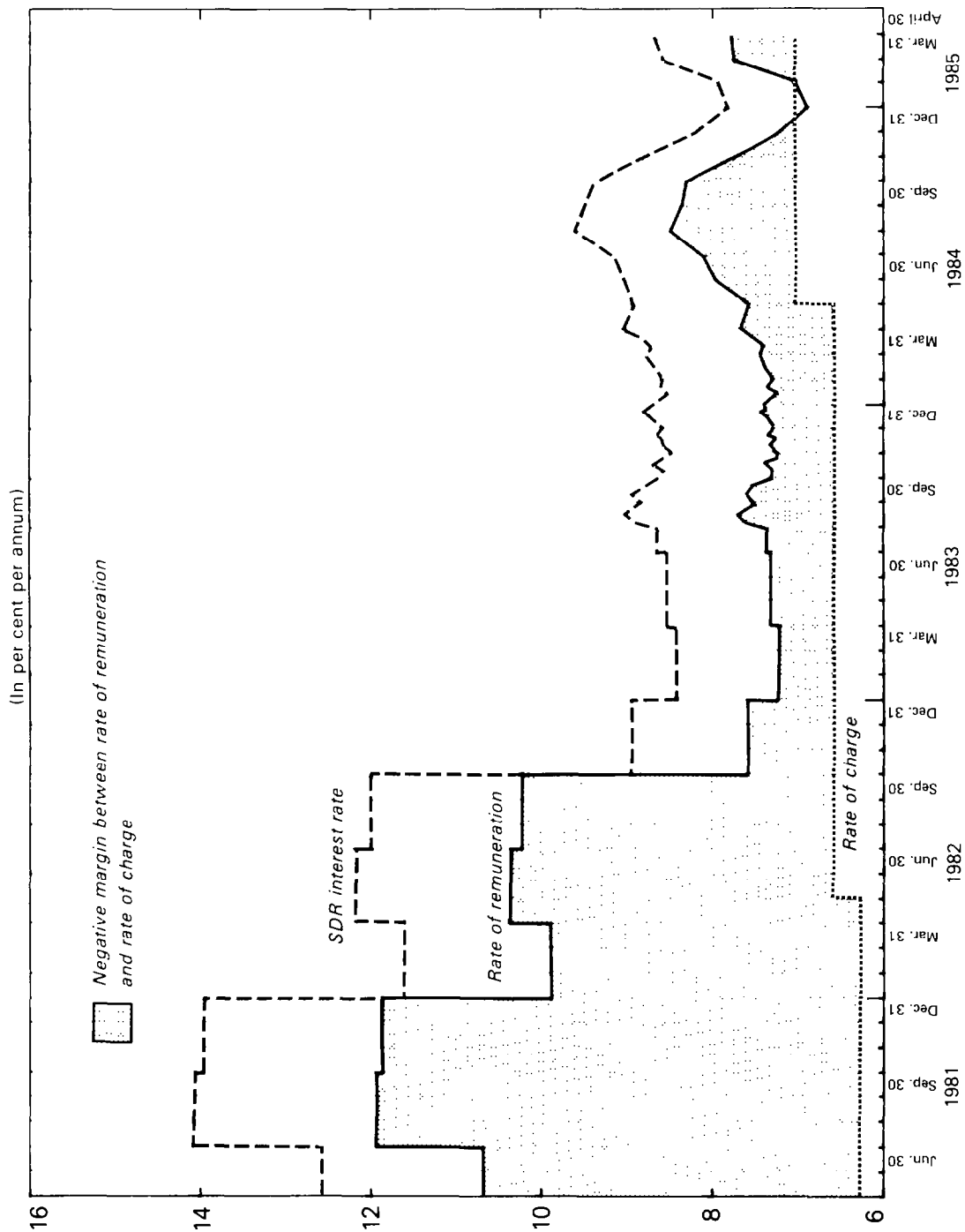




CHART 2
USE OF FUND RESOURCES

(In millions of SDRs)

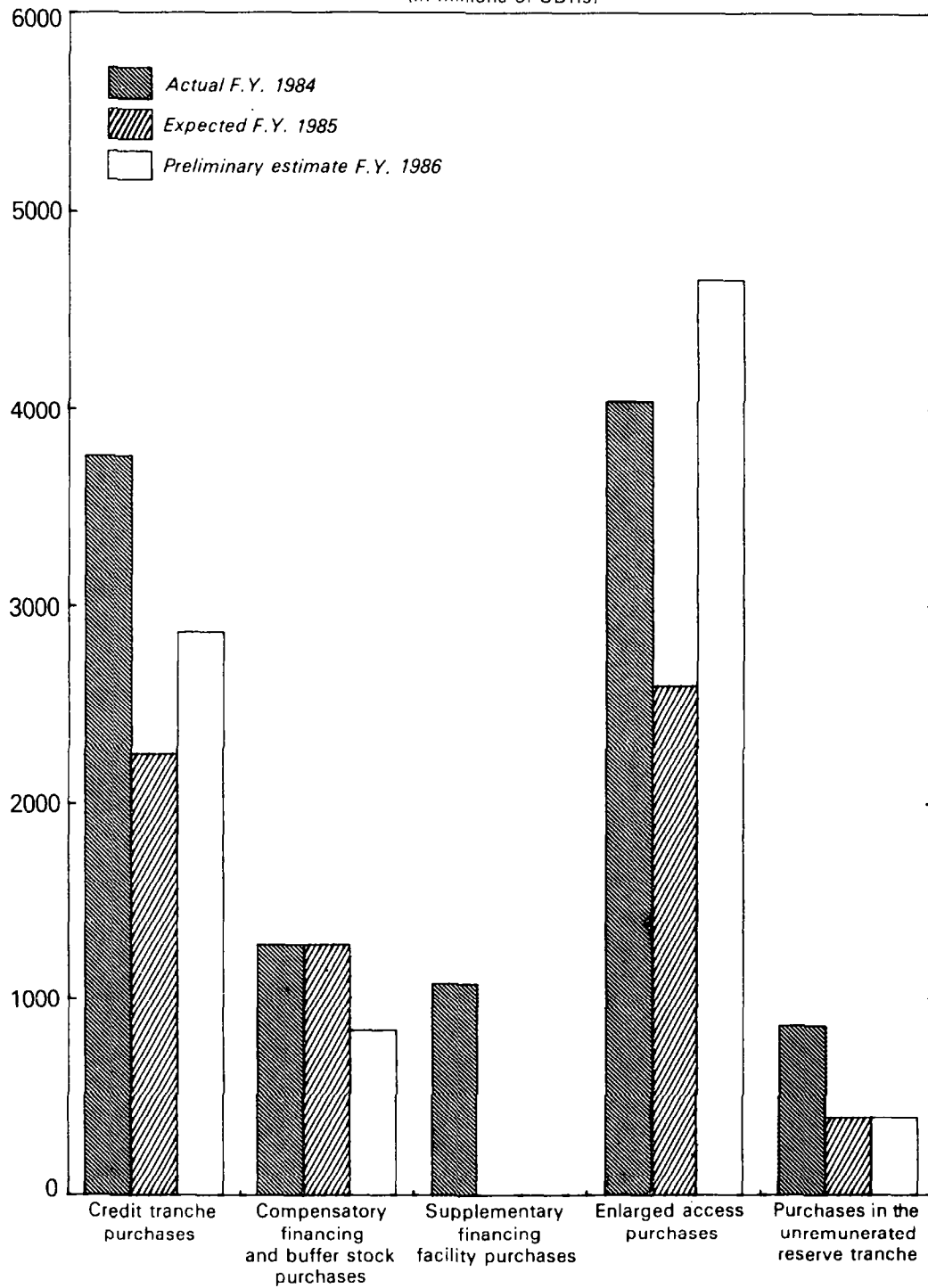
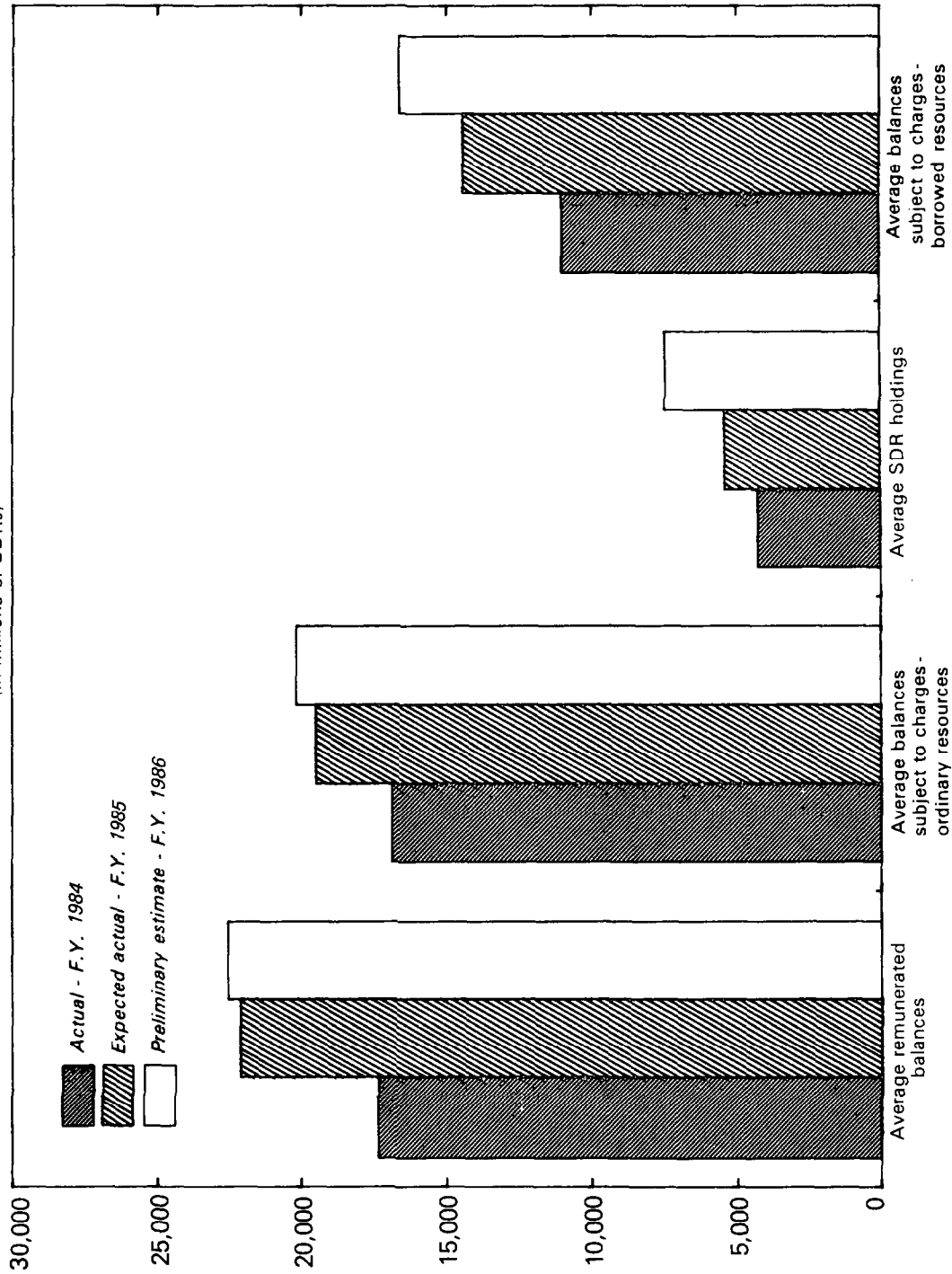




CHART 3
**AVERAGE REMUNERATED POSITIONS, BALANCES SUBJECT TO CHARGES,
 AND HOLDINGS OF SDRs**
 (In millions of SDRs)



Rule I-6(4):

(4) The rate of charge on holdings acquired as a result of a purchase (i) in the credit tranches, or (ii) under the Extended Fund Facility (Executive Board Decision No. 4377-(74/114), as amended), or (iii) under the Facility for the Compensatory Financing of Export Fluctuations (Executive Board Decision No. 4912-(75/207), as amended), or (iv) under the Facility for the Problem of Stabilization of Prices of Primary Products (Executive Board Decision No. 2772-(69/47), as amended), or (v) under the Facility for Compensatory Financing of Fluctuations in the Cost of Cereal Imports (Executive Board Decision No. 6860-(81/81)), shall be determined in accordance with (a), (b), and (c) below.

- (a) The rate of charge shall be determined at the beginning of each financial year on the basis of the estimated income and expense of the Fund during the year and the target amount of net income for the year. The latter shall be 3 percent of the Fund's reserves at the beginning of the year or such other percentage as the Executive Board may determine particularly in the light of the results in the previous financial year.
- (b) A mid-year review of the Fund's income position shall be held shortly after October 31 of each year. If actual net income for the first six months of the financial year, on an annual basis, is below the target amount for the year by an amount equal to, or greater than, two percent of the Fund's reserves at the beginning of the financial year, the Executive Board will consider how to deal with the situation. If on December 15 no agreement has been reached as a result of this consideration, the rate determined under (a) at the beginning of the year shall be increased as of November 1 to the level necessary to reach the target amount of net income for the year.
- (c) A review of the Fund's income position shall be held shortly after the end of each financial year. If the net income for the year just ended is in excess of the target amount for the year, the Executive Board will consider whether the whole or a part of the excess should be used to reduce the rate of charge, or increase the rate of remuneration to not more than the rate of interest of the SDR, retroactively for the year just ended, or both, or to place all or part of the excess to reserve.
- (d) If the Fund's net income for a financial year is in excess of the target amount for that year, the Executive Board may for the purposes of the determinations and estimates referred to in (a) and (b) above in respect of the immediately subsequent financial year, decide to deem any part of the excess over the target amount that has been placed to reserve as income for that subsequent financial year.

Rule I-10:

(a) The rate of remuneration shall be equal to 85 percent of the rate of interest on holdings of SDRs under Rule T-1 (hereafter referred to as the "SDR interest rate"). The relationship of the rate of remuneration to the SDR interest rate will be referred to as the "remuneration coefficient".

(b) Beginning April 30, 1984, the remuneration coefficient during each quarter shall be at the level determined under (1), (2), (3), and (4) below, but no higher than permitted by Article V, Section 9(a):

- (1) During the period May 1, 1984 to April 30, 1987, the remuneration coefficient shall be the higher of (i) or (ii) below:
 - (i) The remuneration coefficient in effect on January 1, 1984 increased by 3.33 percentage points in each of the three financial years beginning May 1, 1984, May 1, 1985, and May 1, 1986;
 - (ii) The remuneration coefficient in effect on January 1, 1984, increased or decreased on the first day of each quarter by one percentage point for each 1/6 of one percentage point that the SDR interest rate on the day before the beginning of the quarter is below or above the SDR interest rate in effect on April 30, 1984, provided that the remuneration coefficient in any quarter in each of these three financial years shall not be more than 2.5 percentage points above the amount of the coefficient for that year as determined under (i) above.
- (2) Following the adjustment in the remuneration coefficient on May 1, 1986, the rate of remuneration shall be reviewed before May 1, 1987. This review shall be conducted in the light of all the relevant considerations, including, in particular, the SDR interest rate and the rate of charge.
- (3) Beginning May 1, 1987, the remuneration coefficient shall be the higher of (i) or (ii) below:
 - (i) The remuneration coefficient existing at the end of the preceding financial year;
 - (ii) A remuneration coefficient of 95 percent, increased or decreased on the first day of each quarter by one percentage point for each 1/6 of one percentage point that the SDR interest rate on the day before the beginning of a quarter is below or above the

SDR interest rate on April 30, 1987, provided that the remuneration coefficient in any quarter of a financial year shall not be more than 2.5 percentage points above the level at the end of the preceding year.

- (4) The rate of remuneration, while less than 100 percent of the SDR interest rate, shall be rounded to the nearest two decimal places.

(c) The operation of (b) above shall be reviewed on the occasion of the reviews of the rate of charge under Rule I-6(4) and the SDR interest rate under Rule T-1(d).

(d) If the rate of charge on holdings specified in Rule I-6(4) should exceed the SDR interest rate, the Executive Board shall review the remuneration coefficient, and, in particular, will consider whether the remuneration coefficient should be set, within the range in Article V, Section 9(a), at such a level as would permit the rate of charge to be set under Rule I-6(4)(a) or (b) at the same level as the SDR interest rate referred to above and still meet the target amount of net income for the financial year.

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Rule T-1(d):

(d) The Fund will review the rate of interest on holdings of SDRs at the conclusion of each financial year.

