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AGENDA**

EBS/85/242

CONFIDENTIAL

October 29, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Special Charges to Recover Costs and Losses Arising from Members' Overdue Financial Obligations to the Fund - Further Consideration

Attached for further consideration by the Executive Directors is a paper on special charges to recover costs and losses arising from members' overdue financial obligations to the Fund.

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

Mr. Dhruba Gupta (ext. 7627) or Mr. Berthet (ext. 7633) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)



INTERNATIONAL MONETARY FUND

Special Charges to Recover Costs and Losses Arising From Members'
Overdue Financial Obligations to the Fund--Further Consideration

Prepared by the Treasurer's and Legal Departments

(In consultation with other Departments)

Approved by W. O. Habermeier and George P. Nicoletopoulos

October 29, 1985

I. Introduction

At EBM/85/90 (6/5/85), the Executive Board discussed various aspects of special charges in relation to overdue financial obligations, on the basis of two papers prepared by the staff. ^{1/} In the course of the discussion, Executive Directors indicated that they were interested in further consideration of the possibility of special charges, and it was agreed that the staff would prepare an additional paper for the Board's consideration, taking account of the views that had been expressed.

Special charges on overdue obligations would be a part of the Fund's overall policies for dealing with the problem of overdue obligations. Executive Directors will wish to consider the issue of special charges in light of recent developments in the overall situation regarding arrears to the Fund, of the associated costs to the Fund and the question whether the members responsible should be asked to bear those costs, and of their judgments whether special charges would be effective in containing the problem.

The overall situation with respect to overdue obligations has continued to deteriorate rapidly, with the amount outstanding rising to the SDR 0.4 billion level at the end of August 1985. Payment delays continue to be experienced by a significant proportion of members having payments due to the Fund, and there has been a substantial increase in amounts overdue for extended periods. The forthcoming six-monthly report on overdue obligations describes recent developments and discusses a number of possibilities which Executive Directors may wish to consider as means of strengthening the Fund's policies to cope with the problem of overdue obligations. The costs to the Fund associated with delays in payment were discussed in detail in EBS/85/121, and it was pointed out that at present these costs are borne by the Fund's membership at large. A majority of the Executive Board expressed support for a

^{1/} "Special Charges on Overdue Financial Obligations to the Fund" (EBS/85/121, 5/13/85) and "Financial Remedies in Connection with Overdue Financial Obligations to the Fund - Legal Aspects" (SM/85/131, 5/13/85).

system of special charges that would, as a minimum, oblige members to compensate the Fund for the financial costs arising from their failures to make payment on time. These costs comprise direct operational costs and losses and added administrative costs resulting from overdue payments. ^{1/} In light of the steep increase in overdue obligations and the continuing effort being made by the Fund to deal with the problem, the costs involved, while still small in absolute terms, are also rising rapidly.

In EBS/85/121 and at the Board meeting on June 5, 1985, a number of conflicting considerations were mentioned regarding the question whether special charges would serve as an effective incentive for payment to the Fund. It was suggested that in cases where members faced deep-seated problems and had large and protracted arrears, special charges, particularly if set at high levels, could exacerbate the members' difficulties and complicate their efforts to overcome them, including their efforts to become current with the Fund. Rather than helping to resolve the problem of overdue obligations, special charges could in such cases make the problem worse. To the extent special charges were not effective and remained unpaid themselves, that would add further to the amounts of overdue obligations outstanding to the Fund and could be seen as compounding the magnitude of the problem both for the countries and for the Fund. On the other hand, it was also suggested that the application of special charges might provide an effective incentive for members to overcome technical or administrative obstacles and encourage them to accord greater priority to payments to the Fund where considerations relating to yield, reserve management or other factors might lead to delays. Furthermore, if special charges helped to forestall the emergence of overdue payments from the outset, they would help to prevent the accumulation of arrears to amounts that may ultimately prove most difficult for members to settle at once. It remains difficult to predict the effectiveness of special charges in helping to secure the settlement of financial obligations to the Fund. In light of the uncertainties, most Directors favoring a system of special charges concluded that, at least until some experience had been gained, the charges should be set at levels that would not exceed the recovery of costs to the Fund.

For these reasons, without taking a position on the subject, the present paper describes a system of this type and presents two options for special charges that would be intended to recover costs to the Fund. It does not discuss other systems that would be designed to go beyond the recovery of costs, for example, systems that would eliminate the concessional element in Fund credit or that would impose a penalty for overdue obligations well above market rates. Section II reviews briefly the purposes of a comprehensive system of cost recovery and summarizes the legal basis on which it would be established; it also considers its main features and certain operational questions, based on

^{1/} The term "cost" is used in this paper, unless the context indicates otherwise, to refer to these elements of cost and loss.

the earlier papers and discussions by the Executive Board. Two alternatives for the structure of special charges under such a system are described in Section III, and Section IV provides a summary. As appropriate in light of the discussion of this paper, a draft decision would be submitted for subsequent consideration by the Executive Board.

II. Features of a System of Special Charges

1. Purpose

As discussed above, the system would be designed to recover direct operational costs, and possibly added administrative costs, arising from delays in payments to the Fund. No attempt would be made to recover indirect costs, such as higher interest rates which creditors might demand to be paid if the Fund had to arrange new borrowing, or other less tangible costs to the Fund's liquidity and reputation. The system would principally attempt to place upon members that fail to make payment on time the responsibility for meeting the resulting costs to the Fund, which now must be borne by the membership at large. By providing certain financial incentives for prompt payment or reducing possible financial incentives which may exist to delay payments, these charges would seek also to reduce the incidence of arrears.

2. Legal basis

As explained in SM/85/131, the Fund has legal authority to recover financial costs and make good losses to the Fund arising from members' failures to make payments to the Fund on time. As Trustee of the Trust Fund, the Fund also has authority to recover similar costs and losses sustained in connection with obligations to the Trust Fund, which result in a reduction in amounts available in the Fund's Special Disbursement Account. This legal authority, which is based on the provisions of the Articles of Agreement, Rules and Decisions of the Fund, and generally accepted principles of law, is summarized below.

a. General Department

(1) With respect to overdue repurchases, the Fund has the authority, after consultation with a member on the reduction of the Fund's holdings of its currency, to impose such charges as it deems appropriate on its holdings of the member's currency that should have been repurchased, under Article V, Section 8(c).

(2) With respect to overdue charges, the Fund may, on the basis of its implied powers, provide that a member is liable to make good losses to the Fund arising from overdue charges.

(3) The Fund may also, on the basis of its implied powers, require members with overdue obligations to indemnify the Fund for added administrative costs resulting from such obligations.

b. SDR Department

The question of recovery of costs to the SDR Department resulting from the nonpayment of charges does not arise in practice, as there is no direct financial cost to the Fund when a participant does not pay charges in the SDR Department. In that event, the Fund creates SDRs to meet the charges due, and the participant incurs the further obligation to pay charges (at the SDR interest rate) on the amount of unpaid charges until the charges in arrears are settled and the SDRs so created are canceled.

The nonpayment of net SDR charges and periodic assessments to cover the expenses of conducting the business of the SDR Department does, however, give rise to added administrative costs, and the latter involves a loss for the Fund in the General Department comparable to losses arising from nonpayment of charges. The Fund could, on the basis of its implied powers, require a participant to make good the loss and the additional administrative cost to the Fund in the General Department resulting from delay in payment of these obligations.

c. Trust Fund

The Instrument establishing the Trust Fund does not make explicit provision for the imposition of special charges on overdue Trust Fund loan repayments or interest. It would, however, be possible for the Fund, as Trustee, to impose charges to recover costs and losses arising from delays in payment of Trust Fund obligations, on the basis of its implied powers.

d. Voting requirements

A decision to impose charges designed to recover the income foregone from the delayed payment of quarterly and semiannual charges in the General Department, periodic assessments, and Trust Fund obligations, and to recover administrative costs associated with overdue payments, could be taken under the Fund's implied powers and the authority of Article XII, Section 2(g) by a majority of the votes cast. The imposition of special charges on overdue repurchases would require a 70 percent majority of the total voting power. Thus, adoption of an integrated system of special charges--i.e., covering repurchases, charges, Trust Fund obligations, and possibly administrative costs--would require a decision taken by a 70 percent majority of the total voting power.

3. Main operational features

A system of special charges with the main purpose of recovering the costs to the Fund resulting from late payments could have the principal features described below.

a. Uniformity of application

Executive Directors were generally agreed that in order to ensure evenhanded treatment of members, a system of special charges should apply uniformly to all members. As discussed in EBS/85/121 and noted by several Executive Directors, the existence of a generally applicable system of special charges would not preclude a decision by the Executive Board to apply further charges to overdue repurchases on an ad hoc basis, outside and in addition to the general system of special charges, in particular circumstances.

b. Timing of application of special charges

In EBS/85/121, the staff mentioned several alternatives as to the point at which special charges might begin to apply following the emergence of an overdue obligation. It was noted that the introduction of even a relatively brief delay before the application of special charges might be thought to convey the impression that the Fund intended a period of grace for the settlement of obligations. In addition, the earliest application of special charges might be most productive in leading members to take prompt steps to overcome difficulties contributing to the emergence of arrears. Accordingly, the staff suggested that it would seem appropriate for such charges to be applied from the date an obligation becomes overdue.

Although this approach was endorsed by a number of Directors, the question was raised whether it might be appropriate to delay the application of special charges for a brief period after a particular obligation becomes overdue, so that such charges would not be applied if a payment were delayed briefly through no fault of the member, e.g., because of a failure by a bank to execute a valid payment instruction in a timely manner. Other considerations that would support brief delay are the requirement to consult with members regarding overdue repurchases (see section (c) below), and the possibility that such a delay would not only encourage but also provide some time for a member to remedy the situation in order to avoid the imposition of special charges.

While these considerations are difficult to balance, it might be possible to reconcile them in part, for example, by allowing a short delay (say, 10 business days) before a member became liable for special charges, and by providing further that, if the obligation in question had not been settled within this period, the special charges would then be imposed from the day the obligation became overdue. Such an approach should provide adequate assurance that special charges would not be imposed precipitously, while helping to minimize the disadvantages of a period of grace. It would also facilitate consistency of treatment between overdue repurchases (on which the Fund and the member must consult, as discussed below) and other obligations.

c. Consultations with members under Article V, Section 8(c)

The application of special rates of charge on overdue repurchases pursuant to Article V, Section 8(c) requires that the Fund consult with a member on the reduction of the Fund's holdings of its currency. In practice, management and staff consult intensively with members immediately upon the emergence of any overdue obligations, including overdue repurchases, in an effort to secure their prompt settlement. In addition, it has been the practice for the staff to inform members that have experienced difficulties in remaining current with the Fund of their forthcoming obligations to the Fund on a quarterly basis, separately from the communications that are sent in connection with each individual obligation as it falls due. This quarterly communication is being broadened to cover all members having obligations falling due within a twelve-month period. Through these and other measures members are thus fully aware of the amounts and due dates of their repurchases and other obligations and of the importance that the Fund attaches to the timely discharge of obligations to the Fund.

In order to satisfy specifically the provisions of Article V, Section 8(c) (which apply only to repurchases), it is proposed that in cases of overdue repurchases existing practice be complemented by a formal consultation with the member on the reduction of the Fund's holding of its currency. This consultation would be initiated through a communication from the Fund, within three business days after due date for the repurchase, urging the member to make the repurchase and notifying it that if the repurchase is not settled within ten business days of the due date, a special charge will be levied, in accordance with the decision establishing the system of special charges, effective as of the day the repurchase was originally due. The member would also be informed of other matters that may be considered relevant in the particular circumstances of the member. Such communications from the Fund would initiate the consultation under Article V, Section 8(c), and a failure of a member to reply to the Fund's communication would not delay application of the special charge. With respect to obligations other than repurchases, all members would be informed of the Fund's decision to establish a system of special charges, and the Fund's regular communications with members having obligations coming due would indicate that a special charge, as provided for in the decision establishing the system of special charges, would apply to late payments if settlement is not made within 10 business days after the due date.

d. Balances subject to special charges and effective date of introduction

As indicated in EBS/85/121, special charges would not be applied retroactively, but it would be necessary to decide whether they should be applied to overdue amounts outstanding at the time the system is introduced, or only to obligations that become overdue in the future, and whether the system should be introduced immediately following a decision by the Board or after some delay. With respect to the first

question, it was pointed out in EBS/85/121 that a system that applied only to future overdue obligations, while minimizing the costs to members already in arrears, would leave unrecovered the continuing costs associated with those obligations and could also create undesirable incentives for settlement of newly-arising obligations in preference to outstanding arrears. The staff, therefore, suggested that special charges should apply both to overdue obligations outstanding as of the date of introduction of the system and to new overdue obligations, and this approach was supported by a number of Executive Directors.

As regards the timing of introduction of the system, there is a risk that delay following the decision to establish a system would be seen to accommodate further delays in payment. This would argue for prompt introduction. However, a number of Executive Directors considered that, particularly if special charges were to apply to obligations outstanding at the time the system was implemented, a brief delay might be desirable in order to give members time to be fully informed, to take the new factor of special charges into account in their planning, and to make any arrangements necessary for the prompt settlement of their obligations to the Fund. If such an approach were favored, the staff would suggest that a delay of about one month should provide adequate notice. The exact date for introduction of the system would be fixed at the time of the Board's decision on the system itself.

e. Recovery of administrative costs

In EBS/85/121, the staff discussed the question of costs and damages to the Fund, other than direct financial costs associated with delays by members in the payment of specific obligations to the Fund. These include, in particular, additional administrative costs.

It is, of course, to be hoped that the problem of overdue obligations and the administrative effort associated with it will diminish in the future. This does not appear to be the case at the present, however, and the question arises whether the Fund should require members with overdue obligations to indemnify the Fund for the administrative costs associated with such obligations. During the June 5, 1985 Board discussion, a number of Directors who addressed the issue expressed support for recouping administrative costs resulting from late payments. While it would not be feasible to determine precisely in each case the administrative costs incurred because of a particular obligation or a particular member's overdue obligations, it would in principle be possible to charge a member an amount representing a reasonable approximation of the additional costs through the addition of a margin to the rate of special charges. However, records on the costs that might properly be regarded as recoverable have not been kept. If desired by the Executive Board, these costs could be monitored more closely and the matter re-examined at a later date.

f. Payment of special charges

It is suggested that all special charges be payable each financial quarter in SDRs, at the same time as regular quarterly charges, which would seem administratively straightforward both for members and for the Fund. Special charges received in respect of losses associated with overdue Trust Fund obligations would be transferred to the Special Disbursement Account, and the remainder would be retained in the General Resources Account.

At EBM/85/90, the question was also raised by an Executive Director whether payment of special charges should have priority over other charges. As Directors are aware, a member is free to attribute payments to any of its obligations, with the exception that SDRs acquired by a participant having overdue net charges in the SDR Department must first be applied against those unpaid charges. If a member does not wish to make an attribution, payment is otherwise applied to the first maturing obligation. If a member had to choose between settling special charges and an underlying obligation (e.g., repurchases, periodic charges, Trust Fund repayments or interest) that was due or overdue, the staff would expect that the member would settle the underlying obligation, in order to avoid the application of (further) special charges on that obligation. In this light, it does not seem necessary to introduce a special rule to guide the order of discharge of special charges in relation to other obligations. Also, partly for this reason, and in order to avoid a "pyramiding" of charges, it is not proposed that special charges be levied on overdue special charges.

g. Treatment of special charges in Fund accounts and income projections

In EBS/85/121, it was suggested that for the purposes of accounting for the Fund's income special charges should be treated in the same way as other charges as regards accrual or nonaccrual. That is, consistent with the recent decision on nonaccrual, special charges would not be accrued but would be recorded as deferred income, if a member had obligations overdue for six months or more (unless it remained current with respect to charges, including special charges) and would be reflected in income only when actually received by the Fund. The staff would propose to follow this approach.

It would not be intended at the outset to include special charges in the projections of income for the purposes of the annual reviews of net income and determination of charges, in light of the uncertainties about the effectiveness of special charges in securing payment and therefore about the collectibility of the charges themselves, and given the lack of any experience with the collection of special charges. The matter would be re-examined in the course of the regular reviews of the system of special charges (see below) or the regular income reviews on the basis of the experience that had been gained, and the staff would make proposals in that light.

h. Reviews of system of special charges

As noted in this and earlier papers and stressed by a number of Directors, the extent to which special charges would constitute an effective instrument in the Fund's efforts to resolve the problem of overdue obligations is difficult to judge in advance of their introduction. Some Directors felt they would not be helpful, and some others considered that rates above levels sufficient to recover costs might be needed to provide an effective incentive for payment. In light of these uncertainties and doubts, it would seem desirable, if a system of special charges were to be established, to envisage a review of the operation of the system after a relatively short period, say, around six months. Regular reviews would permit, inter alia, an assessment of whether the system had helped to deal with the problem of overdue obligations and should be continued or terminated, and whether any changes in the basis for calculation of special charges were warranted. The staff would suggest that a first review might be held shortly after the end of the current financial year at the same time as the regular review of the Fund's income position and the rate of charge, and in a similar manner annually thereafter. Experience with the system would be reported also in the six-monthly reports on overdue financial obligations, which would provide an occasion for Executive Directors to consider whether an earlier review was warranted. The system of special charges and the basis for rates levied under it would remain unchanged unless modified by the Executive Board.

III. Structure of Special Charges ^{1/}

This section illustrates two alternatives for the structure of special charges in a system intended to recover the operational costs to the Fund arising from overdue obligations. Option A is based on System (a) as illustrated in Section V of EBS/85/121, and applies special charges to each obligation on the basis of the costs to the Fund associated with that type of obligation. The rates of special charge under this system thus differ by type of obligation, and the system tends to equalize the "effective" rates of charge, resulting from the combination of normal and special charges, applying to the various types of overdue obligations. Option B applies a uniform rate of special charge to the various types of obligations (with one exception noted below), based on an estimate of annual costs to the Fund associated with overdue obligations. As discussed above, neither of the options would involve, at this stage, a margin designed to recover administrative costs.

^{1/} The operational losses arising from the various types of overdue obligations to the Fund are discussed in detail in EBS/85/121, pp. 12-14.

A. Option A

1. General Department. In EBS/85/121, the staff suggested that the SDR rate of interest would constitute a reasonable and appropriate basis for the determination of special charges on overdue obligations in the General Department under a system intended to recover operational costs to the Fund. This basis for calculation of costs was endorsed by a number of Executive Directors.

(i) Under this approach, costs would be recovered in respect of overdue charges (including overdue charges on stand-by and extended arrangements) at the SDR rate of interest on a daily basis during the period for which the charges were outstanding (on the basis the SDR interest rate of 7.35 percent applying at the end of August 1985, the rate would thus be 7.35 percent).

(ii) Special charges on overdue repurchases financed with ordinary resources would be calculated at a rate equivalent to any positive difference between the SDR rate of interest and the rate of charge on the use of ordinary resources. (On the basis of the SDR rate at end-August, the special charge on overdue repurchases of ordinary resources would amount to 0.35 percent, in addition to the regular rate of charge of 7 percent.)

(iii) As explained in EBS/85/121, delays in repurchases of borrowed resources do not, under present arrangements for borrowing and for calculating associated charges, give rise to direct financial costs to the Fund, and no special charge would be applied. The nature of such arrangements could, of course, change and could lead to the imposition of special charges on overdue repurchases of borrowed resources as well.

2. SDR Department. For the reasons explained in Section II 2(b), delays in payment of net SDR charges do not give rise to direct operational costs to the Fund. Special charges could be levied on overdue assessments, payable to the General Department to cover the costs of conducting the business of the SDR Department, which give rise to losses comparable to losses associated with the nonpayment of charges in the General Department. However, in view of the fact that overdue assessments have so far been extremely small (the amount outstanding at the end of August 1985 was SDR 26,062), Directors may wish to consider not imposing special charges on overdue assessments for the time being even if a generalized system of cost recovery is introduced, subject to review at a later date.

3. Trust Fund. As regards overdue obligations to the Trust Fund, it was indicated in EBS/85/121 that a rate that could be used as a basis to recoup income forgone as a result of delays in repayments or payments of interest would be the yield on investments of these resources with the BIS. The rate used in the simulation in that paper was 9.80 percent, which was the average yield on 12-month deposits with the BIS in 1984.

Table 1. Option A--Illustrative Summary of Special Charges

(Based on obligations and rates of charge and interest prevailing on August 31, 1985)

Type of obligation	Basis of calculation	Normal rate of charge	Rate of special charge (Percent)	"Effective" rate of charge	Overdue obligations (SDR millions)	Annualized income from special charges
Repurchase (OR)	Difference, if positive, between SDR rate of interest and rate of charge on ordinary resources	7.0	0.35	7.35	167.3	0.6
Repurchase (BR)	None	9.8 <u>1/</u>	--	9.8	87.9	--
Charges <u>2/</u>	SDR rate of interest	--	7.35	7.35	113.6	8.3
Net SDR charges	None	7.35	--	7.35	13.0	--
Trust Fund repayment	SDR rate of interest less 1/2 percent per annum <u>3/</u>	0.5	6.85	7.35	36.6	2.5
Trust Fund interest	SDR rate of interest	--	7.35	7.35	<u>1.0</u>	<u>0.1</u>
Total					419.4	11.5

OR = ordinary resources

BR = borrowed resources

1/ Weighted average of charges on borrowed resources (EAR and SFF) at August 31, 1985.

2/ Includes quarterly charges, semiannual charges on use of borrowed resources and stand-by charges on arrangements.

3/ SDR rate of interest less the rate of interest on Trust Fund loans of one-half percent per annum.

Though this rate would be consistent with the principle of recovering income that would have been earned, it has been noted that this would mean applying to defaults on Trust Fund obligations a market rate which tends to exceed the SDR rate that is proposed to be applied in the General Resources Account. In this light, it might be preferable to use the SDR interest rate as a proxy basis for the calculation of earnings forgone. This would have the merits of simplicity and consistency with the basis applied to other obligations, and would normally be expected to result in rates of special charge on overdue Trust Fund obligations somewhat below the yield on investments. Calculated on the basis of the SDR interest rate on August 31, 1985, the special charge applicable to overdue Trust Fund interest would be 7.35 percent (the SDR interest rate) and that applicable to overdue loans would be 6.85 percent (the SDR interest rate less the 0.5 percent rate of interest on Trust Fund loans).

On the basis of the foregoing, Table 1 provides an illustration of the rates that would apply to the different types of overdue obligation under Option A and of the estimated income to the Fund if the rates of interest and charges applying on August 31, 1985 were to apply for a full year to obligations outstanding on that date. The illustrative annualized income from special charges shown in the last column of the table, totaling SDR 11.5 million, is, by the same token, the estimate of annual costs (aside from administrative costs) that the Fund would experience if the overdue obligations outstanding and the relevant rates of interest and charge were to prevail for a full year. Special charges would be calculated as the product of the daily balance of the obligations overdue and the applicable rate of special charge on that day, as determined by the then current SDR rate and rate of charge on ordinary resources.

B. Option B

The system of special charges under Option A outlined in the preceding paragraphs applies to each overdue obligation special charges based on the cost associated with that obligation. The rates of special charges applied therefore differ by category of obligation, and (with the exception of overdue repurchases of borrowed resources) result in the same "effective" rates of charge resulting from the combination of regular and special charges. Consideration could be given to a simpler and more straightforward alternative of applying a more uniform special charge to overdue obligations, while remaining, however, in the framework of a system based on the recovery of operational costs to the Fund.

Such uniform special charges would be determined as follows. The Fund would estimate the annual financial costs associated with overdue obligations, on the basis of the outstanding obligations and relevant rates of charge and interest prevailing at the time of estimation, similar to the calculations in the table above on Option A. Based on these estimates, special charges would be calculated as a uniform rate which, applied to all overdue obligations other than overdue obligations

in the SDR Department, would yield an amount equivalent to the estimated financial costs to the Fund. (As noted above, overdue net SDR charges do not give rise to direct operational costs and would not be subject to special charges under the system described.)

For example, annualized operational costs associated with obligations in the General Department and the Trust Fund in the illustration above are estimated at SDR 11.5 million. Overdue repurchases and charges in the General Department plus overdue Trust Fund obligations amounted to SDR 406.4 million on August 31, 1985. Therefore, a uniform rate of 2.83 percent per annum applied to these obligations would yield, on an annual basis, an amount approximately equivalent to the estimated costs to the Fund arising from these overdue obligations, i.e., about SDR 11.5 million. The rates of special charge discussed under this option are illustrated in Table 2 below. The estimates of costs and the rate of special charge would be reviewed and if necessary modified as part of the broader reviews of the system conducted at the same time as the regular reviews of the Fund's income.

In sum, a uniform rate of special charge would be applied to all overdue obligations in the General Department and the Trust Fund. The rate would not exceed and would, in fact, be substantially less than, the rate that the Fund would be able to impose in respect of overdue charges in the General Department and overdue Trust Fund obligations on the basis of implied powers. 1/ By comparison with Option A, the application of uniform special charges under this option would reduce the rates of special charges applied to overdue charges and Trust Fund obligations and increase the rates applicable to overdue repurchases.

The application of a uniform special charge under this option would appear to offer several advantages. The rate of special charge would remain fixed for a substantial period, and the system should be easily understood by members and relatively simple to administer. The system would apply a noticeable financial incentive for the settlement of overdue obligations, 2/ including overdue repurchases of borrowed

1/ The rate could exceed costs associated specifically with overdue repurchases. The Fund has authority to impose such charges as it deems appropriate on overdue repurchases and is therefore not limited to the recovery of costs associated specifically with these obligations (although in this instance the purpose would remain related to the recovery of costs arising from the general problem of overdue obligations). As for overdue charges in the General Department and Trust Fund obligations, as the Fund would have authority on the basis of implied powers to impose special charges at rates based on the SDR interest rate as discussed above, it would also have authority to impose special charges at lower rates.

2/ Although no special charge would be applied in respect of net SDR charges, any acquisition of SDRs by a member (for example, to pay charges) is utilized first in settlement of any net SDR charges that may be overdue, and the settlement of these charges thus tends already to be accorded some priority under the Articles.

resources. And it would help to avoid the imposition of special charges on overdue Trust Fund obligations at rates that might appear to be unduly high in the context of a concessional facility. While it would not assess costs with respect to specific obligations with the precision of Option A above, it would remain based on the recovery of operational costs to the Fund and compatible with the Fund's authority to recover those costs.

Table 2. Option B--Illustrative Summary of Special Charges

(Based on obligations and rates of charge and interest prevailing on August 31, 1985)

Type of obligation	Normal rate of charge	Rate of special charge (percent)	"Effective" rate of charge	Overdue obligations (SDR millions)	Annualized income from special charges
Repurchase (OR)	7.0	2.83	9.83	167.3	4.7
Repurchase (BR)	9.8 <u>1/</u>	2.83	12.63	87.9	2.5
Charges <u>2/</u>	--	2.83	2.83	113.6	3.2
Net SDR charges	7.35	--	7.35	13.0	--
Trust Fund repayment	0.5	2.83	3.33	36.6	1.0
Trust Fund interest	--	2.83	2.83	<u>1.0</u>	<u>--</u>
Total				419.4	11.5

OR = ordinary resources
BR = borrowed resources

1/ Weighted average of charges on borrowed resources (EAR and SFF) at August 31, 1985.

2/ Includes quarterly charges, semiannual charges on use of borrowed resources and stand-by charges on arrangements.

IV. Summary and Conclusions

This paper has been prepared in response to a request by the Executive Board. It discusses the operational features of a system of special charges in light of the examination earlier in EBS/85/121 and SM/85/131 and the views of Executive Directors given at EBM/85/90, and illustrates the structure of special charges under two options that would set rates at levels intended to recover the direct operational costs to the Fund associated with overdue obligations. If the Board were to consider that the recent deterioration in the overall situation regarding overdue obligations, and the rising operational costs associated with it, warranted the introduction of a generalized system of special charges that would be designed to recover these costs to the Fund arising from overdue financial obligations, the system could take one of the forms outlined in this paper. The main features of a possible system are summarized below.

1. This paper has presented two options with respect to the structure of special charges, in the context of a system designed to recover the costs to the Fund associated with overdue obligations. 1/

(a) Under Option A, calculations of special charges to recover direct financial costs to the Fund would be based on the SDR rate of interest as regards overdue obligations in the General Department and overdue Trust Fund obligations, as described in detail in EBS/85/121 and Section III(A) above.

(b) Under Option B, annual costs would be estimated by the Fund on the basis of obligations outstanding and relevant rates of interest and charges prevailing at the time of the estimate. On the basis of this estimate, a rate of special charge would be derived which would, applied uniformly to overdue repurchases, charges in the General Department, and Trust Fund obligations, yield the estimated costs to the Fund associated with these obligations.

2. In other respects, the operations of the system under the two options would be the same.

(a) The system would apply uniformly to all members.

(b) Giving effect to the consultation requirements of Article V, Section 8(c), the Fund would initiate consultations with a member not later than three business days after a repurchase became overdue and would inform the member that a special charge would be applied, from the due date, if the repurchase were not settled within 10 business days after the due date.

1/ Neither option would include provision for estimated administrative costs. If desired by the Executive Board, these costs could be monitored and the question re-examined at a later stage.

(c) Special charges would apply from the due date to all other obligations that were overdue for more than 10 business days.

(d) A delay of about one month following the Executive Board's decision to establish the system should provide adequate notice to members prior to the introduction of special charges. These charges would not be applied retroactively but would apply to all overdue obligations outstanding on the date of introduction of the system with effect from that date and arising after that date, subject to paragraphs (b) and (c) above. All computations would apply the relevant rates to outstanding obligations on a daily basis.

(e) Special charges would be payable quarterly, in SDRs, at the same time as regular quarterly charges to the General Resources Account. It is not proposed to introduce a special rule for the order of discharge of special charges, nor to apply further special charges to special charges that may become overdue.

(f) Special charges would be treated in the same way as other charges as regards accrual and nonaccrual in the income and expense statements prepared and published by the Fund. Projections of receipts of special charges would not be included at the outset in projections of income for the purpose of the annual review of income and determination of the rate of charge; this matter would be re-examined in the light of experience.

(g) The system and the basis for rates of special charges levied under it would remain in effect unless modified by the Executive Board by a 70 percent majority of the voting power. ^{1/} A review of the workings of the system would take place periodically. The staff recommends that a first review take place shortly after April 30, 1986 at the time of the annual review of the Fund's income position for FY 1987, and in a similar manner annually thereafter. Interim reports on the operation of the system would be included in the six-monthly reports on overdue obligations to the Fund.

3. As appropriate in light of the Executive Board's discussion of this paper, a draft decision would be submitted for the consideration of the Board.

^{1/} Provided that a modification not involving special charges on overdue repurchases could be made a majority of the votes cast. See Section II(2) above.