

The Acting Chair's Summing Up
Review of the Fund's Policy on Multiple Currency Practices—Proposals for Reform
Executive Board Meeting 22/63
July 1, 2022

Executive Directors welcomed the opportunity to complete the review of the Fund's Policy on Multiple Currency Practices (MCPs). They observed that MCPs can be distortionary, create unfair competitive advantage among countries, and hamper trade and investment, particularly over the medium and long term. They agreed that the MCP policy should remain a cornerstone of the Fund's legal and policy framework to ensure orderly exchange arrangements and a stable system of exchange rates. They welcomed the adjustments to the policy to reflect developments since the last review in the 1980s so that it does not discourage good practices in FX markets and is better aligned with the Fund's other policies (including the policy on exchange restrictions and the Institutional View on the Liberalization and Management of Capital Flows (IV)), while ensuring that it continues to address policy actions that are considered impermissible under the new policy.

Directors supported the reform proposals. They concurred that the main principle of the policy—that official action by members' governments or their fiscal agencies should not cause unreasonable deviations in exchange rate spreads compared to normal costs and risks of exchange transactions—remains valid, although a few Directors stressed that the Fund should continue to approach the policy from an economic rather than a legalistic perspective. Directors agreed to eliminate the practice of finding an MCP due to potential exchange rate spreads.

Directors agreed that the scope of official action by members' governments and fiscal agencies should be clarified to focus primarily on action that segments the FX markets and/or increases or decreases the cost of exchange transactions. Directors agreed that FX auctions that are in line with best practices would not give rise to an MCP, as they do not segment the FX market. Directors also agreed that an official exchange rate calculated based on the preceding day's market rates would not give rise to an MCP.

Directors agreed that foreign exchange purchases and sales by the authorities (aside from auctions) that do not segment the FX market would be excluded from the scope of the revised policy. However, Directors noted that if such FX transactions make foreign currency available at a particular exchange rate only for specific purposes or to a subset of end-users or intermediaries, therefore segmenting the FX market, such transactions would be assessed under the policy.

Directors agreed that exchange rate spreads with illegal parallel markets would no longer be considered MCPs, but the underlying distortions would be captured under the Fund's policy on exchange restrictions, where relevant. However, Directors stressed that

country authorities should make reasonable efforts to eliminate illegal parallel markets and that staff should continue to discuss them in staff reports. Directors also agreed that broken cross rates caused by official action would no longer be considered MCPs, as reliance on such practices has almost disappeared and thus they are no longer economically relevant.

Directors agreed that since NDFs are not exchange transactions, they would only be considered under the MCP policy if they are closely related to acquiring or selling foreign exchange. Directors agreed to retain the current treatment of agreements between central banks under the MCP policy.

Directors welcomed the proposal to replace the current fixed two-percent rule for spot FX transactions with a country-specific market-based norm (the High/Low range) and tolerance margin (+/- 2 percent), whichever is wider, which will be used also for non-spot FX transactions. Directors broadly agreed that the Fund may find an MCP whenever there is a single deviation outside this range due to official action, but a few Directors called on staff to consider possible refinements to this approach in the next review. Directors agreed that additional costs or subsidies that are sufficiently closely related to an exchange transaction should be considered part of the effective exchange rate to be used in the assessment. As a continuation of the current policy, exchange taxes not exceeding 2 percent applied on market exchange rates will not give rise to an MCP.

Directors noted that the new policy does not introduce new data provision requirements. The relevant market exchange rate data is collected from reputable third-party providers, but staff can use data that are representative of the FX market from alternative sources, if needed. Directors noted that members will be expected to continue to provide data necessary for MCP assessments beyond that required under Article VIII, Section 5.

Directors agreed that an MCP will be considered eliminated if the authorities cease the official action that gave rise to the MCP, take credible measures to bring the spread back within the permissible range, or the impermissible spread does not reoccur following an observation period of 12 months.

Directors agreed that the use of the FX system for purposes unrelated to the balance of payments should generally be discouraged. They also agreed to strengthen the criteria for temporary approval of MCPs maintained primarily for non-BOP circumstances by additionally requiring that the member commits to a credible strategy for removal and that the MCP does not constitute an exchange restriction. A few Directors saw the benefits of a review of the Fund's policy on exchange restrictions.

Directors broadly agreed with the proposals to enhance the current cooperative approach to noncompliance by increasing transparency and accountability. They generally supported more prominent and extensive coverage of MCPs in staff reports, including more

consistently reporting the existence of measures, discussion of their economic impact, staff's advice on removal, and the authorities' plans. A few Directors, however, cautioned that this could cause reputational risks to the authorities and preferred maintaining the current level of coverage. Directors welcomed annual reporting to the Board of a list of all approved and unapproved MCPs. Directors highlighted the role of Fund advice and technical assistance in promoting the elimination of MCPs and the reform of FX markets. Directors noted that the Board will revisit the issue of a remedial framework for unapproved MCPs in future reviews of the new MCP policy, taking into consideration the experience with the enhanced cooperative approach. A few Directors suggested similarly revisiting the issue of extending the MCP policy to capital transactions.

In line with the recently endorsed provisions of the IV, Directors agreed that MCPs and exchange restrictions that are also considered CFMs as they are also designed to limit capital flows would be assessed only under the respective Article VIII policy. Directors agreed that MCPs that apply solely to capital transactions are not subject to Fund approval but will continue to be identified as MCPs in Article IV reports and will be assessed only under the IV.

Directors welcomed the transitional arrangements to ensure the smooth implementation of the new MCP policy, which will become effective nine months following the Board approval of the decision with a few exceptions. Effective immediately, no MCPs will be found due to official exchange rates computed with a one-day lag, foreign exchange auctions consistent with best practices, spreads arising from illegal parallel markets, and broken cross rates caused by official action. Directors welcomed staff's plan to conduct outreach to the membership on the new policy during the transitional period. They noted that only limited additional resources will be required once the policy is well-established. Directors agreed that the new MCP policy will be reviewed within five years, or on an as-needed basis.