



IMF POLICY PAPER

METHOD OF COLLECTING EXCHANGE RATES FOR THE CALCULATION OF THE VALUE OF THE SDR FOR THE PURPOSES OF RULE O-2(A)

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METHOD OF COLLECTING EXCHANGE RATES FOR THE CALCULATION OF THE VALUE OF THE SDR FOR THE PURPOSES OF RULE O-2(A)

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- 1. This paper proposes modifications to the method of collecting exchange rates for the calculation of the value of the SDR for the purposes of Rule O-2(a).** The value of the SDR in terms of the U.S. dollar is determined daily as the sum of the equivalents in U. S. dollar values of the amounts of the currencies that comprise the SDR valuation basket (as provided in Rule O-1), calculated on the basis of exchange rates established in accordance with procedures decided from time to time by the Fund.¹ The current procedures are set out in Decision No. 6709-(80/189) S, as amended by Decision No. 12157-(00/24) S, March 9, 2000 (see Annex), which specifies the method for collecting exchange rates for this purpose. Under these procedures, the relevant currency amounts are converted into U.S. dollars using daily exchange rates that are provided to the Fund by the Bank of England (BoE). If rates cannot be obtained from the BoE, they are provided by the Federal Reserve Bank of New York (FRBNY) and, if not available there, by the European Central Bank (ECB). The BoE, FRBNY, and ECB intend to rely on a new, more robust methodology to provide exchange rates to the Fund after November 1, 2016, and the proposed modifications reflect these changes.
- 2. Since the current procedures were last modified in 2000, more robust technologies and methodologies have been developed to capture exchange rates.** The BoE's current practices for determining the exchange rates involve taking indicative exchange rates that its Foreign Exchange Desk observes in the market at noon London time.² In line with evolving best practice, efforts have been made to source market exchange rates captured using more robust methodologies. In particular, there is presently at least one commercial provider (WM/Reuters) that uses a transactions-based and IOSCO-aligned methodology to publish exchange rates at regular intervals throughout the global trading day.³ More specifically,

¹ See Rule O-2(a).

² While the first back-up provider, the FRBNY, follows a similar procedure as the BoE but at noon New York time, the exchange rates provided by the ECB are based on a regular daily concertation procedure between central banks across Europe, which normally takes place at 2:15 pm Central European Time.

³ The International Organization of Securities Commissions (IOSCO) is an association of organizations that regulate the world's securities and futures markets. Concerns about the quality of benchmarks across a range of financial markets prompted IOSCO to develop an internationally agreed set of principles for financial benchmarks (the "IOSCO

these rates capture representative spot exchange rates sourced from highly liquid trading platforms used in major financial centers during a five-minute window, including for London noon time.⁴

3. **In line with these developments, the BoE intends to provide exchange rates to the Fund primarily sourced using a new, more robust methodology.** The BoE has reviewed the transactions-based and IOSCO-aligned methodology used currently by at least one commercial provider (WM/Reuters) to calculate exchange rates.⁵ It considers, and staff agrees, that using exchange rates calculated using this methodology would strengthen the robustness of the exchange rates provided for the purpose of calculating the value of the SDR.⁶ Accordingly, the BoE will provide to the Fund exchange rates that it intends to obtain from a commercial provider using this methodology. In exceptional circumstances where rates could not be obtained using this approach, the BoE would revert to a process whereby it would provide to the Fund market exchange rates observed by its Foreign Exchange Desk at around noon London time.

4. **The FRBNY and the ECB will continue to serve as back-up providers, and both intend to provide exchange rates to the Fund primarily sourced using the same new methodology that the BoE intends to use.** On days when the BoE is closed but the Fund is open for business, the FRBNY (or the ECB, if both the BoE and the FRBNY are closed) intends to provide the Fund with relevant exchange rates using the same new methodology as the BoE.⁷ However, in cases when the spot exchange rates observed around noon London time are not available based on this new methodology, the FRBNY would revert to a process whereby the FRBNY would provide to the Fund market exchange rates that it observes at around noon New York time; if both the BoE and FRBNY are closed and rates based on the new methodology are not available, the ECB would provide to the Fund market exchange rates observed at 2.15 pm Central European Time. If the rate for any currency against the United States dollar cannot be obtained directly in any of these markets, the rate will continue to be calculated indirectly by use of a cross rate against another currency specified in Rule O-1.

5. **It is proposed that effective November 1, 2016, the Board decision on the method of collecting exchange rates for the calculation of the value of the SDR be amended to reflect**

principles”) which cover governance, quality of data, and accountability. See *OICU-IOSCO Principles for Financial Benchmarks Report*, dated July 2013 (<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>).

⁴ WM/Reuters provides an exchange rate service that publishes spot and forward benchmark rates at fixed times throughout the global trading day for over 160 currencies. These spot exchange rates use the same methodology that applies to the WM/Reuters 4 pm Closing Spot Rate, a benchmark regulated by the UK Financial Conduct Authority (UK FCA).

⁵ While the back-tests did not reveal significant differences vis-à-vis the current methodology, the IOSCO-aligned approach is more transparent and more likely to produce exchange rates that are representative of actual market conditions.

⁶ The exchange rates will cover all non-U.S. dollar SDR basket currencies (Chinese renminbi, euro, Japanese yen and Pound sterling).

⁷ For consistency purposes and with a view to source the exchange rates under the typically most liquid market conditions, the FRBNY would generally provide the Fund with rates at around noon London time rather than at around noon New York time.

the changes discussed above.⁸ The amended decision would allow a more robust and more transactions-based methodology to be applied for collecting the exchange rates for the daily valuation of the SDR and also help harmonize the approaches currently used by the BoE, FRBNY, and ECB for the purpose of Rule O-2(a). Following its adoption and consistent with past practice, it is also proposed that this decision be published.

⁸ Attachment I shows in redline the proposed changes to the Decision on the Method of Collecting Exchange Rates for the Calculation of the Value of the SDR for the Purposes of Rule O-2(a)

Proposed Decision

The following decision, which may be adopted by a majority of votes cast, is proposed for adoption by the Executive Board:

Effective November 1, 2016, Decision No. 6709-(80/189) S, December 19, 1980, as amended by Decision No. 12157-(00/24) S, March 9, 2000, shall be further amended to read as follows:

Method of Collecting Exchange Rates for the Calculation of the Value of the SDR for the Purposes of Rule O-2(a)

1. For the purpose of determining the value of the United States dollar in terms of the special drawing right pursuant to Rule O-2(a), the equivalents in United States dollars of the amounts of currencies specified in Rule O-1 shall be based on spot exchange rates against the United States dollar. For each currency the exchange rate shall be the mid-market rate, as provided to the Fund by the Bank of England, based on spot exchange rates observed at around noon London time.
2. If the exchange rate for any currency cannot be obtained as described in paragraph 1 above, the rate shall be the mid-market rate, as provided to the Fund by the Federal Reserve Bank of New York, based on spot exchange rates observed at around noon London time or, if not available, the mid-market rate based on spot exchange rates observed at around noon New York time.
3. If the exchange rate for any currency cannot be obtained as described in paragraph 1 or 2 above, the rate shall be the mid-market rate, as provided to the Fund by the European Central Bank based on spot exchange rates observed at around noon London time or, if not available, the market exchange rates observed at 2.15 pm Central European Time.

4. If the rate for any currency against the United States dollar cannot be obtained directly in any of these markets, the rate shall be calculated indirectly by use of a cross rate against another currency specified in Rule O-1.

5. If on any day the exchange rate for a currency cannot be obtained in accordance with paragraph 1, 2, 3, or 4 above, the rate for that day shall be the latest rate determined in accordance with paragraph 1, 2, 3, or 4 above, provided that after the second business day the Fund shall determine the rate.

Attachment I. Redlined Decision

Method of Collecting Exchange Rates for the Calculation of the Value of the SDR for the Purposes of Rule O-2(a)

1. For the purpose of determining the value of the United States dollar in terms of the special drawing right pursuant to Rule O-2(a), the equivalents in United States dollars of the amounts of currencies specified in Rule O-1 shall be based on spot exchange rates against the United States dollar. For each currency the exchange rate shall be the mid-market rate, as provided to the Fund by the Bank of England, based on spot exchange rates observed at around noon London time.
~~middle rate between the buying and selling rates at noon in the London exchange market as determined by the Bank of England.~~
2. If the exchange rate for any currency cannot be obtained as described in paragraph 1 above,
~~from the London exchange market~~ the rate shall be the mid-market rate, as provided to the Fund by the Federal Reserve Bank of New York, based on spot exchange rates observed at around noon London time or, if not available, the mid-market rate based on spot exchange rates observed at around noon New York time.
3. If the exchange rate for any currency cannot be obtained as described in paragraphs 1 or 2 above, the rate shall be the mid-market rate as provided to the Fund by the European Central Bank

based on spot exchange rates observed at around noon London time or, if not available, the market exchange rates observed at 2.15 pm Central European Time.

~~4. at noon in the New York exchange market determined by the Fund on the basis of the buying and selling rates communicated by the Federal Reserve Bank of New York or, if not available there, the middle rate determined by the Fund on the basis of the euro reference rates of the European System of Central Banks communicated by the European Central Bank.~~ If the rate for any currency against the United States dollar cannot be obtained directly in any of these markets, the rate shall be calculated indirectly by use of a cross rate against another currency specified in Rule O-1.

~~53.~~ If on any day the exchange rate for a currency cannot be obtained in accordance with paragraph 1, or 2, 3, or 4 above, the rate for that day shall be the latest rate determined in accordance with paragraph 1, or 2, 3, or 4 above, provided that after the second business day the Fund shall determine the rate.